07/03/2019

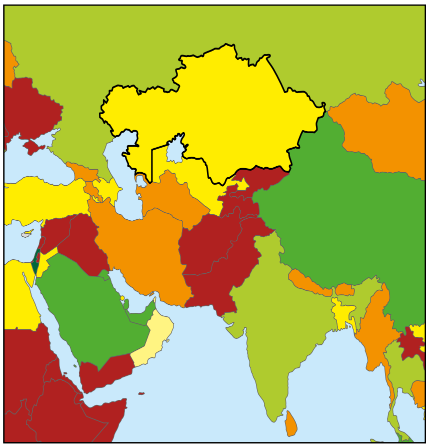
5/7 COUNTRY RISK CATEGORY

COUNTRY RISK ANALYSIS

Kazakhstan

0 1 2 3 4 5 6 7

The country risk categories are arranged on a scale from 0 to 7.
The lower the figure, the better the country's creditworthiness.



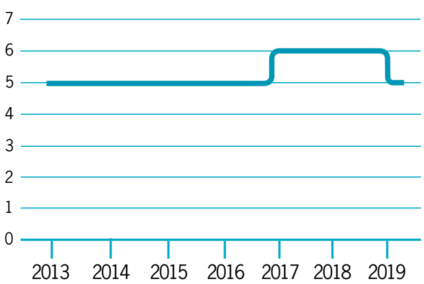
CONTACT

Name: Martin Sturinge
Tel: +46 (0)8 788 00 56
e-mail: martin.sturinge@ekn.se

BASIC FACTS

Population:	18 million (2018)
GDP, nominal:	USD 184 billion (2018)
GDP/capita:	USD 9 977 billion (2018)

COUNTRY CLASSIFICATION HISTORY



Source: EKN

Positive risk development in Kazakhstan

Continued economic growth, strong public finances and favourable oil price forecasts have motivated an upgrading of Kazakhstan to country risk category 5 in February 2019. In general, the country has come relatively unscathed out of the economic crisis of 2014/15, partly due to the oil price recovery and partly through policy decisions, such as transitioning to a managed float exchange rate regime in August 2015. As before, areas of concern include the economy's oil price sensitivity, the substantial foreign debt and the unstable banking sector. The business and investment climate also remains a challenge. President Nazarbajev stepping down increases the political uncertainty, but this is not expected to entail any significant changes. It will likely be an orderly succession, where power remains with the old elite. All in all, EKN considers Kazakhstan to have stable prospects based on the current country risk category.

THE COUNTRY'S STRENGHTS AND WEAKNESSES

STRENGTHS

+ Budget surplus and a low level of public debt.
+ Satisfactory international reserves and strong hard currency earnings from export of oil, gas and minerals.
+ High GDP per capita for a country in Central Asia.

WEAKNESSES

- Large private foreign debt and a high debt service ratio in relation to GDP. At the same time, the business environment and banking sector are weak.
- Public finances and exports are sensitive to changes in oil prices.
- Weak institutions and succession risk.

SWEDISH EXPORT TO KAZAKHSTAN, MSEK

	MSEK
2018	1 012
2017	1 074
2016	1 314
2015	708
2014	679

Source: SCB

EKN:S EXPOSURE

	MSEK
Guarantees	48
Offers	95

EKN:S POLICY

EKN places Kazakhstan in country risk category 5 of 7 since 2019. This classification is determined in consultation with the other OECD countries. EKN applies a normal risk assessment for pure sovereign risks, but other public buyers require a letter of credit guarantee, bank guarantee or sovereign guarantee. Normal risk assessment is also applied to bank and corporate risks.

EKN:S EXPOSURE AND EXPERIENCE

EKN has reduced its commitment significantly compared to ten years ago, when it exceeded SEK 1 billion. Every year, guarantees are provided for an average of six transactions, most in the mining and transport industries. Following the global financial crisis of 2008, indemnifications to a value of approximately SEK 125 million were made, and no indemnifications have been made since then. Arrears increased in 2017/18, likely as a delayed effect of the economic crisis in the country. However, there are no outstanding arrears at present.

EKN assesses the risk of negative impact on the environment and human rights in all transactions. Out of the seven guarantees issued by EKN in Kazakhstan since 2014, all were in Class C[1].

WHAT MIGHT CAUSE A CHANGE IN THE COUTRY POLICY

EASING:

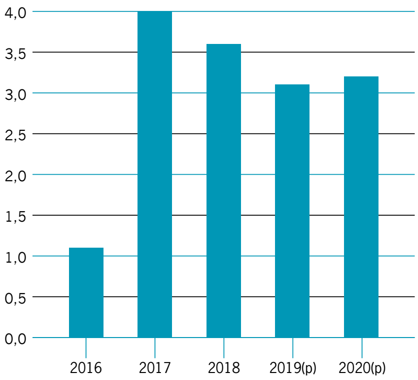
- Significantly reduced foreign debt and debt service ratio.
- Reduced oil price sensitivity through stronger macroeconomic policy and/or diversification of the government-dominated economy.

TIGHTENING:

- Strongly deteriorated public finances as a result of, for example, a permanent fall in oil prices or a banking crisis.
- A current account deterioration and decreasing international reserves, in combination with the high level of foreign debt, will give the country balance of payments problems.

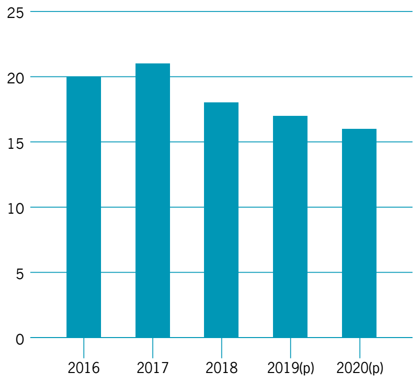
[1] Class A describes a substantial negative impact, Class B a limited negative impact and Class C a small impact or none at all.

GDP-GROWTH (% PER ANNUM)



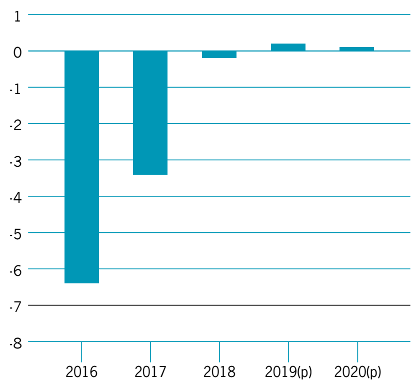
Source: IMF WEO 2018

PUBLIC DEBT (% of GDP)



Source: IMF WEO 2018

CURRENT ACCOUNT (% of GDP)



Source: IMF WEO 2018

COUNTRY ANALYSIS

BACKGROUND

A high level of growth through oil exploitation has made Kazakhstan an upper middle-income country, where less than 3 per cent of the population is living below the national poverty line. The foundation was laid in the first decade of the 2000s, when the economy was growing at an average 8.5 per cent per year, and the proportion of Kazakhstani citizens under the poverty line dropped by more than 40 percentage points. However, since 2010, the average growth rate has more than halved, and an economic crisis erupted in 2014–2015 due to a fall in oil prices and the economic downturn in Russia. During the crisis, export revenues decreased by 42 per cent, the Kazakhstani Tenge lost 60 per cent of its value against the US Dollar, and inflation came close to 18 per cent. An authoritarian regime represented by President Nursultan Nazarbajev has been governing Kazakhstan since the dissolution of the Soviet Union in 1991.

MOST RECENT TRENDS

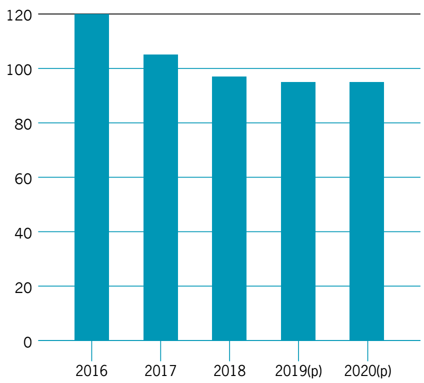
Four years after the start of the crisis, the Kazakhstani economy continues to move in a positive direction. Higher oil prices are helping the economy, which grew by 3.6 per cent in 2018, while inflation has dropped to just over 5 per cent. Increased tax revenues mean that the public deficit has been turned to a small surplus of 1.6 per cent of GDP. Exports have made a recovery in the past two years and imports have been adjusted, which means that the current account is close to being balanced. Also contributing to the improved external position is a decreasing level of foreign debt (97 per cent of GDP), satisfactory international reserves (a little over four months' import coverage) and a relatively stable Tenge following the introduction of a managed float exchange rate.

The banking sector has been somewhat reinforced following the economic crisis, but it remains weak due to a high average proportion of non-performing loans, weak regulation and extensive exposure to the US Dollar. Several of the country's major banks are in serious financial trouble, including Tsesnabank, which was downgraded to selective default (SD) by the rating institute Standard & Poor's for a brief period between January–February 2019. Halyk Bank, which currently owns approximately 40 per cent of the banking system's total assets, has a high proportion of non-performing loans.

LONG-TERM TREND

Kazakhstan's credit worthiness in a 3–5-year perspective has improved, which prompted the upgrading of Kazakhstan to country risk category 5 in February 2019. The country has emerged relatively unscathed out of the economic crisis, especially from a public finance perspective. Despite the substantial drop in oil prices and the fact that nearly 50 per cent of the total national revenue constitutes oil and gas revenues, the public debt is low for a category-5 country (approximately 18 per cent of GDP) and indicates a downwards trend. Furthermore, the public debt is more or less exclusively medium to long term, which limits the refinancing risk. The proportion of foreign currency loans

EXTERNAL DEBT (% of GDP)



Source: IMF 2018

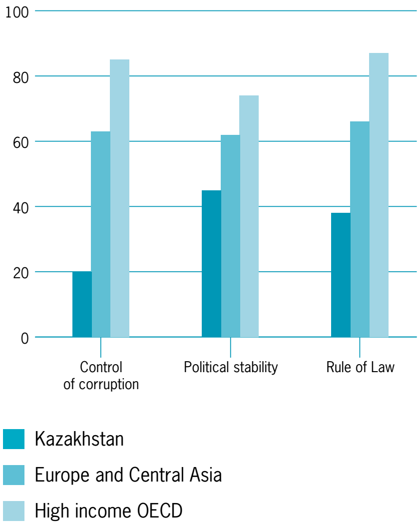
increased sharply in conjunction with the crisis due to the exchange rate fall, but the external payment obligation is still low and will not cause payment problems for the central government. A forecasted oil price of USD 60–70 per barrel makes it likely that the growth rate and the budget surplus will continue. This means that no deterioration of the country's credit rating is to be expected in the coming years.

The greatest risks instead lie in the external position and the weak banking sector. Even though the foreign debt has decreased as a proportion of GDP in later years, the debt level is still very high compared to other countries in risk category 5. Combined with a high debt service ratio of nearly 50 per cent, the foreign debt constitutes a substantial refinancing risk for the private sector, where approximately 90 per cent of the debt is found. Furthermore, 60 per cent of Kazakhstan's exports comprises oil and gas, which makes the current account vulnerable to fluctuations, primarily in the oil price. The weak banking sector has been highly subsidised by the government in the last decade, and more bailout packages will likely be required in the future. There is thus an impending risk of the debt situation and/or the banking sector affecting the government's balance sheet.

However, there are a number of factors indicating that the situation will be manageable. The high level of private foreign debt consists mainly of internal company-to-company loans, which reduces the risk of suspended payments due to more relaxed terms of lending. Kazakhstan's hard currency earnings also remain strong, and the international reserves are likely large enough for the country to manage its foreign debt and handle potential bailout packages in the future as well – especially considering that the very large current account deficit of recent years has virtually been erased and the exchange rate has stabilised. The managed float exchange rate places less pressure on the international reserves and reduces the risk of creating economic imbalances compared to before, when Kazakhstan had a fixed exchange rate. The banking sector's share of GDP is also small compared to other growth economies, which reduces the risk of spillover from the banking sector to the general economy. Finally, the probability of foreign support in the event of a crisis is high – its relationship with China allowed Kazakhstan to receive an emergency loan during the global financial crisis of 2009.

There are further risks entailed by the weak business climate, including a high level of corruption and weak institutions, which constitutes a significant weakness compared to other category-5 countries. Reforms of government institutions, the legal system and cadastral rights are necessary, along with privatisation, in order to produce more dynamic growth, but there has been limited political support for such measures thus far. President Nazarbajev's unexpected decision to leave office in March 2019 is not expected to entail any changes in this regard. A succession plan that ensures political continuity and sees to it that power is retained by Nazarbajev's family and allies seems to be in place. The speaker of the parliament, a close ally of Nazarbajev, will assume the presidency up until the presidential

BUSINESS ENVIRONMENT



Ranking from 0 (worst) to 100 (best)
Source: The World Bank

election in 2020. For now, Nazarbajev retains his role as head of the country's security council and leader of the ruling party. Nazarbajev's eldest daughter, who took over as speaker, is a potential presidential candidate for 2020.

All in all, EKN considers Kazakhstan to have stable prospects based on the current country risk category. A more negative outlook is possible if the public finances and external stability become threatened due to an oil price shock, a large-scale banking crisis, a debt crisis or a political crisis.

BUSINESS ENVIRONMENT

Kazakhstan is ranked 28 of 190 in the World Bank's Doing Business Index, which is three places ahead of Russia. Compared to other countries in Central Asia, Kazakhstan is ranked significantly higher, and several international companies have chosen to set up their regional offices in the country. Foreign investments are made primarily in the oil and gas sector, where the government is actively engaging in dialogue with international investors. The country is a member of WTO since 2015 and is working towards OECD membership, which would indicate an improved business climate in the long term. Sweden has a bilateral investment protection agreement with Kazakhstan since 2016.

However, the World Bank's review does not provide a complete picture of the business climate. Government dominance, widespread corruption and cumbersome bureaucracy are still to be expected for companies in Kazakhstan. Large, politicised, quasi-public corporations and banks dominate the economy and are in practice given competitive advantages. There are instances where the government questions contractual rights, passes legislation to benefit domestic businesses and meddles in the activities of foreign companies. Institutions and the legal system are weak, especially at the local level, where legal practices can be unpredictable and arbitrary. Widespread corruption further damages trust in the legal system. Kazakhstan is ranked 124 of 180 in the Transparency International Corruption Perception Index, which is the highest of Central Asia and roughly on a par with Russia. Among other challenges are an antiquated transport and telecom infrastructure, which requires extensive investments. In regard to currency transfer risks, Kazakhstan has ratified IMF's Article VIII regarding currency convertibility, and the Tenge is also convertible in practice. Thanks to its large international reserves, stable hard currency earnings and a current account recovery, the risk of serious capital controls being introduced is limited.