Kazakhstan Unrest Unlikely To Spur Fundamental Reform

Feb. 2, 2022

This report does not constitute a rating action.

Key Takeaways

- **The recent mass protests and civil unrest in Kazakhstan reflect the structural weakness and fragility of its institutional framework, which we already incorporate in our sovereign ratings.** Protests began in response to an increase in fuel prices, but quickly grew to encompass broader grievances, including persistent inequality, low wages and living standards, and political representation constraints. The sudden and acute outburst of civil unrest highlights the underlying risk of social upheaval, in our view, absent the implementation of government policy that is responsive to societal priorities.
- **The government has announced a number of transformative initiatives that will likely affect Kazakh corporates and government-related entities (GREs).** It has outlined that its priorities are to improve corporate governance, transparency, and operating efficiency. The credit quality of Kazakh state-owned enterprises will depend on its current steps, such as changes to taxation, state-support mechanisms, and tariff frameworks. We currently anticipate that the government's actions will be tangible, but balanced.
- **Banking sector functionality was quickly restored, after a few days of temporary suspension in early January.** The direct damage to the banking sector due to vandalism seems relatively limited. However, there are several areas of risk, where uncertainty remains high for Kazakh banks. We see only a limited impact for local insurance companies (both property/casualty and life insurers). In most cases, existing insurance policies did not cover the risks related to damaged property, business interruption, and citizens' life and health.

CONTACTS

Max McGraw
Dubai
+971-4372-7168
maximillian.mcgraw
@spglobal.com

Trevor Cullinan
Dubai
+971-4372-7113
trevor.cullinan
@spglobal.com

Sergei Gorin
Moscow
+749-5788-4132
sergei.gorin
@spglobal.com

Irina Velieva
Moscow
+749-5783-4071
mohamed.damak
@spglobal.com

CONTENTS

PRIMARY CONTACT

Max M McGraw
Dubai
+971-4372-7168
maximillian.mcgraw
@spglobal.com

Trevor Cullinan
Dubai
+971-4372-7113
trevor.cullinan
@spglobal.com

Sovereigns

Institutional Weaknesses Outweigh Prudent Policymaking

The mass protests and civil unrest witnessed during the first week of January 2022 reflect the structural weakness and fragility of Kazakhstan's institutional framework that are already incorporated in our sovereign ratings. The protests began in response to an increase in fuel prices, but quickly grew to encompass broader grievances, including persistent inequality, low wages and living standards, and aging infrastructure, constraints on political representation, and the perceived high level of corruption. The situation has since calmed down and reports indicate that life has mostly returned to normal. However, the sudden and acute outburst of civil unrest highlights the underlying risk of social upheaval, in our view, absent the implementation of government policy that is responsive to societal priorities.

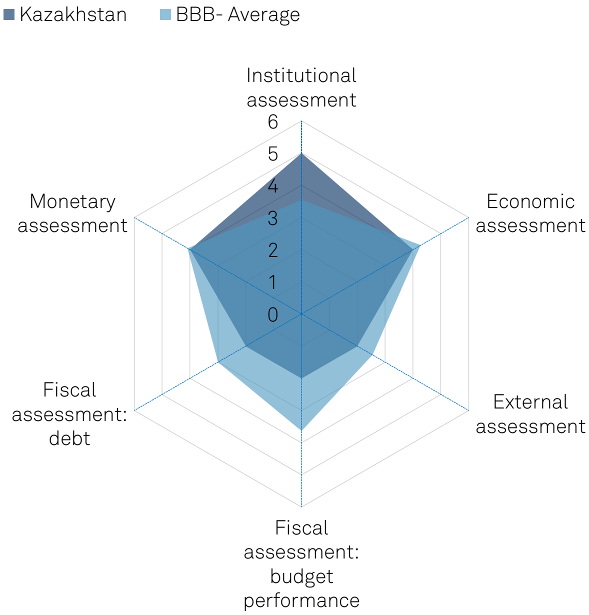
Ignited by an increase in the price of liquified petroleum gas, protests in the western part of the country quickly spread throughout Kazakhstan, with Almaty--the largest city--eventually seeing the most violent clashes between protestors and security forces, and the most damage. After undoing the fuel price increase, putting caps on other socially sensitive prices, and dismissing the government, President Kassym-Jomart Tokayev declared a state of emergency (the first since 2011). As protests continued to grow in intensity--which the government blamed on foreign agitators--he requested assistance from the Collective Security Treaty Organization (CSTO), a mutual defense organization with members from ex-Soviet states (Russia, Armenia, Belarus, Kazakhstan, Kyrgyzstan, and Tajikistan). CSTO peacekeeping troops, mostly from Russia, arrived quickly and order was restored. Banks reopened, tenge trading resumed on Jan. 12, and a week later the state of emergency was lifted and CSTO troops had completed their withdrawal.

President Tokayev now appears to have solidified his position and our base-case expectation is that he will serve out the remainder of his term, ending in 2024. The 2019 transfer of power to President Tokayev from his predecessor Mr. Nursultan Nazarbeyev, who had been in the post for nearly 30 years, seemed only a partial transfer. Mr. Nazarbayev remained very influential. In response to the protests, however, and in an effort to demonstrate a clean break with the old regime, President Tokayev assumed the role of chairman of the security council, removing Mr. Nazarbayev from his last vestige of formal power. President Tokayev also assumed chairmanship of the ruling Nur Otan political party from Mr. Nazarbayev, on Jan. 28. Nevertheless, succession risks remain while political and economic power transfers from the old regime to the new. Additionally, elections lack credibility, according to many third-party observers, thereby reducing assurances of a smooth transfer of power and putting limitations on the electorate's ability to make its voice heard.

In addition to succession risk, we believe that **the centralized decision-making inherent in Kazakhstan's institutional settings will continue to cloud the predictability of government decision-making.** President Tokayev plans to unveil a political reform package during his state-of-the nation speech in September 2022. We remain skeptical as to the extent of real political reforms. Reforms to devolve power and diversify decision-makers within the government have so far been relatively limited. There have been some efforts to improve the transparency and accountability of institutions. Still, checks and balances in the government are limited, there is no credible political opposition party, limitations on independent media outlets are significant, and perceived corruption is high. Although macroeconomic policy planning is generally prudent and effective, uncertainty over the political landscape is likely to remain a constraint on our view of the sovereign's institutional framework and thus on the overall sovereign rating.

Chart 1

Kazakhstan Sovereign Rating Scores (BBB-/Stable/A-3)



Source: S&P Global Ratings.

Table 1

Kazakhstan Key Risk Indicators

	2020	2021F	2022F	2023F	2024F
GDP per capita (USD '000)	9.1	9.6	10.1	10.5	11.0
Real GDP growth	-2.5	3.5	3.6	3.9	3.5
Unemployment rate	4.9	4.9	4.9	4.9	4.9
GG balance/GDP	-7.2	-4.0	-1.8	-1.0	-0.6
GG interest/revenues	6.2	6.9	7.4	7.7	7.7
GG Debt/GDP	28.5	30.9	31.3	30.9	30.2
CA/GDP	-3.8	-2.8	-2.6	-2.2	-2.5
Narrow net ext. debt/CAR	-38.2	-37.8	-35.0	-33.8	-35.4
Net FDI/GDP	3.5	3.0	3.0	3.0	3.0
Exchange rate (year-end, KZT/$)	420.9	430.0	439.5	449.0	457.0

GG--General government. CA--Current account. FDI--Foreign direct investment. CAR--Current account receipt. KTZ--Kazakh tenge. Source: S&P Global Ratings.

As political reforms are difficult to undertake, we believe that the government will focus its efforts on reducing the population's discontent on the economic front. President Tokayev will announce details of his promised socioeconomic reforms in February. These will likely aim to address jobs, wages, infrastructure needs, a reduction in the state's participation in the economy, and an increase in economic diversification. Yet, while we think the reforms are likely to help to prevent any return to the recent social upheaval, they are unlikely to address all of the protesters' concerns.

We think it unlikely that the civil unrest will harm economic growth over 2022. There could be heightened concern from foreign investors over the business climate and uncertain political framework. Still, foreign direct investment is largely concentrated in extractive industries, a sector in which investors have been operating in Kazakhstan for a number of years and have a tolerance for the level of country risk. We currently expect the economy to expand in real terms by 3.6% over 2022 (the government's preliminary estimate for 2021 is 4%). However, higher oil prices and the prospect of elevated government spending this year will likely provide upside to this forecast, as state spending is an important engine of non-oil growth in Kazakhstan.

The recent unrest will keep government spending elevated in 2022, following efforts over 2021 to reduce it in the wake of the large COVID-19 pandemic-related increase in 2020. The government's initial estimates for the direct costs of the unrest are between $2 billion and $3 billion (about 1% of GDP) and the socioeconomic spending will add to the budget relative to 2021. More importantly than this short-term impact, the recent protests highlight the population's sensitivity to fiscal changes. It will be more difficult for the government to implement structural changes such as tariff rises, bringing prices of goods and services to market levels, or further tax reform, for example. These changes can still happen, but we would expect implementation will be at a more gradual pace. Despite the expectation of elevated spending, the government's fiscal position should remain strong. Oil prices have increased significantly--more than one-third of the government's revenue comes from oil. And production levels are increasing as OPEC+ cuts taper off. In 2023, production from the Tengiz oilfield expansion will start to come on stream, boosting production levels. The government remains in a net asset position, with a significant level of assets accumulated in the National Fund of the Republic of Kazakhstan (NFRK), largely invested abroad.

Government-Related Entities

PRIMARY CONTACT

Sergei Gorin
Moscow
+749-5788-4132
sergei.gorin
@spglobal.com

The Government Spotlights Efficiency Improvements

The government has announced a number of initiatives that will likely affect the country's corporate and GRE sectors as a fallout to the civil unrest in Kazakhstan in early January 2022**.** Many details are still evolving and will become more evident in the coming months. Given heavy state involvement in the corporate sector it is no surprise that the main focus was the state-owned entities. Notably, the government has outlined its priorities as improving its corporate governance, transparency, and operating efficiency. The medium-term development of Kazakh GREs' credit quality will depend on current steps, such as changes to taxation, state support mechanisms, and tariff frameworks, which we will continue to monitor. At present, we anticipate these actions will be tangible, but balanced.

First, we do not expect significant measures affecting the state-owned enterprises that would trigger mergers, liquidations, or changes of control. The Samruk-Kazyna Fund was specifically mentioned in the context of questionable efficiency, to which the entity has responded with detailed proposals on cost and headcount optimization, steps to increase procurement procedures' transparency, and an updated strategy to improve financial efficiency. This is likely to mean, among other things, larger dividend payouts by its portfolio companies--Kazmunaygas, Kaztransoil, QazaqGas, KEGOC, Kazatomprom and others. As we understand it, this is a starting point for the discussion with the government and it remains to be seen whether the proposals will be accepted. We note that the suggested reforms have a financial focus.

Second, we think that the transparency of the decision-making mechanisms, instruments, and timeliness of state support could be improved. There is likely to be a considerable improvement, at least in transparency over how GRE projects are selected, monitored, exercised, and supported. The government will likely set clearer strategic priorities for its GREs in order to improve coordination and mutually beneficial outcomes. The planned IPOs and SPOs of key state-owned corporates (KMG and Air Astana for 2022, KEGOC and QazaqGas in 2023, with Samruk-Energy to follow) might potentially create upside for an improvement in corporate governance. We expect that the state will remain the key shareholder and decision-maker.

Third, we think there could be an improvement in energy infrastructure. The recent disruption in KEGOC's high-voltage grids resulted in electricity disruption in two neighboring countries--Uzbekistan and Kyrgyzstan. The event manifested existing weaknesses in Kazakhstan's energy system, which will require not only investment, but also well-coordinated planning between generators, fuel suppliers, grids, and electricity users, with heavy involvement of regulatory bodies. We think that Kazakhstan has a material requirement to deepen its strategic planning and coordination among many sectors, such as commodities, energy, infrastructure, renewables, and equipment suppliers.

Financial Institutions

Immediate Damage Manageable, Long-Term Risks Uncertain

The functioning of the banking sector has been restored, after being suspended for a few days in early January. The direct damage from vandalism seems relatively limited in scale. However, there are several areas of risk, where uncertainty remains high for Kazakh banks. These include:

The impact of unrest on the borrowers' payment discipline, especially in SME and retail segment. We believe that the capacity of many SME and retail borrowers to service debt, especially in the city of Almaty, where the largest protests unfolded, may have been harmed by the events in January. At the same time, economic fundamentals remain supportive, which could partly offset the negative effect on asset quality. For corporate borrowers, high political uncertainty and event risks might affect their ability and willingness to pay. Nevertheless, our base-case scenario implies that payment disruptions, if any, will only be temporary. We do not expect a meaningful prolonged increase in nonperforming loans in the sector.

Changes in the banking sector's competitive landscape. We still see that many banks remain reliant on the business and political connections of their owners. Over the past few years, the number of banks in the sector has reduced significantly, and further license withdrawals are unlikely, in our view. However, potential event risks are starting to loom for many privately owned banks, since they are reliant on the sustainability of existing political connections of their owners, which is now uncertain.

Potential (although not yet materializing) deposit instability. Although we saw no major deposit instability, either among corporate or retail clients in January, we view customer funds as confidence-sensitive. The risks are partly offset by the banks' traditionally high liquidity cushions (approximately 30%) on their balance sheets. However, the movement of corporate deposits, or deposits of government-related entities, may create a liquidity squeeze for individual banks.

Limited Effects For The Insurance Sector

We see only a limited impact for local insurance companies (both property/casualty and life insurers). In most cases, the risks related to damaged property, business interruption, and citizens' life and health were not covered under existing insurance policies because the January events were classified as mass protest and civil unrest. Voluntarily, local insurers still covered some claims on case-by-case basis, but we do not expect the related losses to put material pressure on insurers' bottom-line results. Similarly, we do not expect any pressure on the insurers' investment results. A significant portion of the insurers' investments are held in domestic government bonds, the prices of which had rebounded by the beginning of February 2022. Insurers' investments in local banks are mostly held in the form of deposits. As the functioning of the banking sector has been restored, we do not expect any losses related to these investments. Finally, the potential foreign currency exchange rate movements could add some volatility to the investment result, but not materially so.

PRIMARY CONTACT

Irina Velieva
Moscow
+749-5783-4071
irina.velieva
@spglobal.com

Victor Nikolskiy
Moscow
+749-5783-4010
victor.nikolskiy
@spglobal.com

Related Research

- Unrest In Kazakhstan Lifts The Lid On Underlying Institutional Weaknesses, Jan. 6, 2022
- Ratings On Eight Kazakhstani Banks Affirmed Under Revised Criteria Despite Elevated Uncertainties; Outlooks Unchanged, Jan 26, 202
- Research Update: Samruk-Kazyna Upgraded To 'BBB-/A-3' On Improved Government Oversight; Outlook Stable, Sep. 7, 2021
- Full Analysis: KazTransOil, Oct. 25, 2021
- Research Update: Kazakhstan Ratings Affirmed At 'BBB-/A-3'; Outlook Stable, Sep. 3, 2021
- Full Analysis: Kazakhstan Electricity Grid Operating Co. (JSC), March 10, 2021