Central Asia And Caucasus Banking Outlook 2025

Positive Momentum Continues

S&P Global Ratings

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This report does not constitute a rating action

Key Takeaways

- We expect banks' performance in Armenia, Azerbaijan, Georgia, Kazakhstan, and Uzbekistan will remain resilient in 2025, similar to 2024. Low double-digit lending growth and stable asset quality will support profitability and capital levels.
- Still favorable economic growth prospects across the region, high lending demand--especially in the retail segment--sound funding and liquidity metrics, and stable capital buffers on the back of solid profitability will support ratings in 2025. As of February 2025, the outlooks on all but two banks in the five countries covered in this report were stable and two outlooks were positive.
- Key risks include elevated geopolitical tensions, a global or regional economic slowdown that will be more pronounced than we expect in our base case, aggressive growth in retail lending, a rapid growth in housing prices that could increase imbalances, and evolving risks related to digitalization, AI, climate change, and cyber threats.
- The regulation, supervision, and governance of regional banking sectors has evolved but remains less transparent and predictable, compared with developed markets. In Kazakhstan and Azerbaijan, regulatory oversight strengthened notably over the past few years. While we still consider that banking regulation and supervision in Georgia are the most advanced in the region, democratic backsliding in the country could impair banking sector regulation and the independence of the banking regulator.

A Hypothetical Ceasefire Between Russia And Ukraine Would Have Limited Effects On Regional Banking Systems In 2025

The exact scope and timing of the possible ceasefire or any other solution to the war are difficult to estimate at this point. However, if a ceasefire scenario were to materialize, we consider its effect on the banking sectors of the countries we cover in this report will be limited, specifically:

Limited effect on economic growth: For Armenia, Georgia and Uzbekistan--the countries where war-related inflows of people and capital from Russia and Ukraine as well as increased trade flows have boosted growth the most in the past few years--our projections already assume some moderation of economic growth. In comparison, war-related inflows from Russia and Ukraine were less pronounced in Azerbaijan and Kazakhstan and had a less material effect on economic growth in these countries.

Gradually reducing non-resident deposit and capital flows: The inflows of non-resident deposits, primarily from Russia, into the region have been gradually diminishing after their 2022-2023 peak. Even if some funds are channeled back to Russia or to third countries, the risk of accelerated deposit outflow is contained, in our view. This is because uncertainty about Russia's macroeconomic and policy outlook, including restrictions related to transfer and convertibility, will remain high over the near term.

Declining fee income growth: Exceptionally strong growth in banks' fees and commissions on currency exchange and transfers over 2022-2023 has gradually reduced. The pace of this normalization could accelerate slightly in 2025, with non-interest income reverting to normal levels.

No material effect on loan growth: We note that individuals and businesses that have relocated to the region due to the war primarily used regional banks for savings and payment services, not for loans. Therefore, their potential departure from the region would not affect lending growth.

Limited effect on housing prices: Largely due to the war-related increase in migration from Russia and Ukraine, rental prices in the region have increased notably over the past three years, especially in Georgia and Armenia. Yet the effect of this on housing prices in the region is less pronounced, in our view. We therefore expect the potential return of migrants to their home countries would have a manageable effect on the housing price dynamics in the region.

Key Risks

Geopolitical tensions

For the five countries covered in this report, balancing political relationship both with the West and Russia will be a challenge, especially since Russia remains the primary trading partner in the region. Armenia faces an additional source of uncertainty due to the prospective peace treaty with Azerbaijan, which requires the resolution of several complex issues. Georgia faces increased domestic political volatility and weakened political predictability.

Sharper-than-expected global or regional economic slowdown

A slowdown in key trading partners' GDP growth, reduced government investments, and reduced internal demand would impair GDP and credit growth prospects in the region.

Increasing imbalances

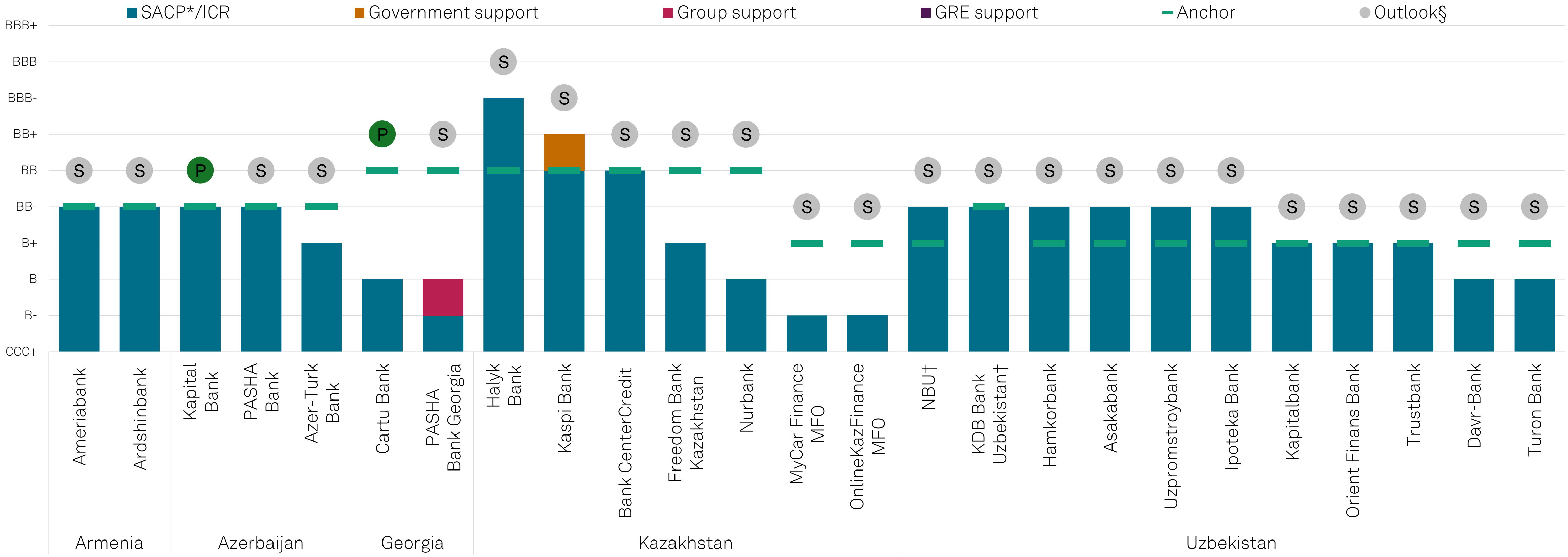
Rapid credit growth, especially in unsecured consumer lending, that reduces borrowers' repayment capacity could increase credit losses. The housing sector could evolve as a driver of imbalances in the region because of strong housing price dynamics.

Digitalization, AI, climate change, and cyber threats

While these evolving risks will challenge regional banks' business models and risk management, they also offer opportunities for those that embrace the challenge and move ahead of others. We expect an increase in credit divergence as the gap between leaders and laggards widens.

Most Ratings On Regional Banks Have A Stable Outlook

The ratings reflect the generally high level of risk for banks operating in the region



*Stand-alone credit profile/issuer credit rating. §P--Positive. S--Stable. †For NBU and KDB Bank Uzbekistan, the SACP is ‘bb’ and the issuer credit rating is ‘BB-’.
GRE--Government-rated entity. Source: S&P Global Ratings.

S&P Global Ratings

Positive Rating Actions Prevailed In 2024

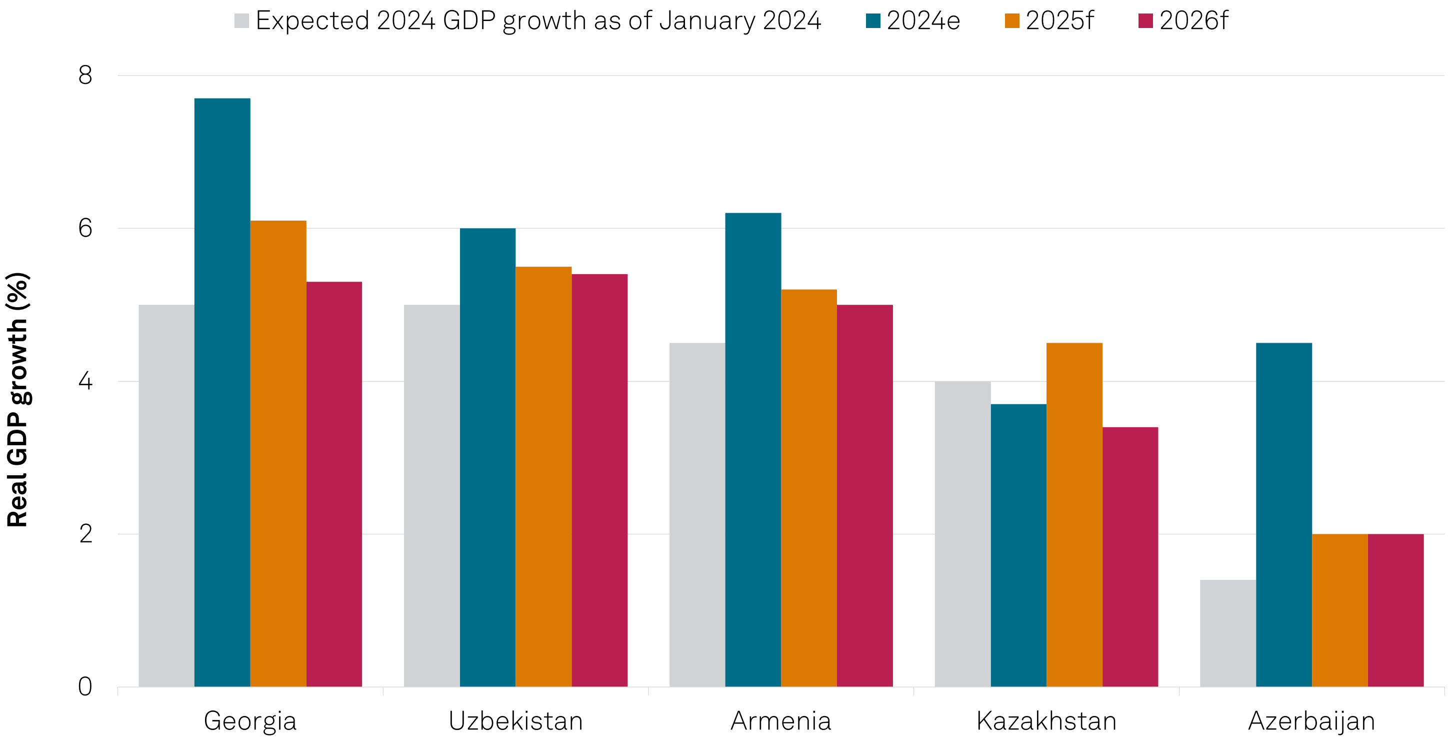
Date of action	Bank	Country	To	From
12/12/2024	Halyk Bank JSC	Kazakhstan	BBB-/Stable/A-3	BB+/Positive/B
12/12/2024	Bank CenterCredit JSC (BCC)	Kazakhstan	BB/Stable/B	BB-/Positive/B
12/12/2024	Nurbank JSC	Kazakhstan	B/Stable/B	B-/Positive/B
12/12/2024	Freedom Bank Kazakhstan JSC	Kazakhstan	B+/Stable/B	B/Positive/B
19/11/2024	JSC PASHA Bank Georgia	Georgia	B/Stable/B	NR
28/6/2024	Freedom Bank Kazakhstan JSC	Kazakhstan	B/Positive/B	B/Negative/B
28/06/2024	Kapitalbank	Uzbekistan	B+/Stable/B	B/Stable/B
19/03/2024	Nurbank JSC	Kazakhstan	B-/Positive/B	B-/Stable/B
19/03/2024	Halyk Bank JSC	Kazakhstan	BB+/Positive/B	BB+/Stable/B
19/03/2024	Bank CenterCredit JSC	Kazakhstan	BB-/Positive/B	BB-/Stable/B
02/09/2024	Ardshinbank CJSC	Armenia	BB-/Stable/B	B+/Positive/B

Source: S&P Global Ratings.

Banks Benefit From Solid GDP Growth Forecasts For 2025

The stable environment will support new business generation and asset quality in the banking sector

Real GDP growth



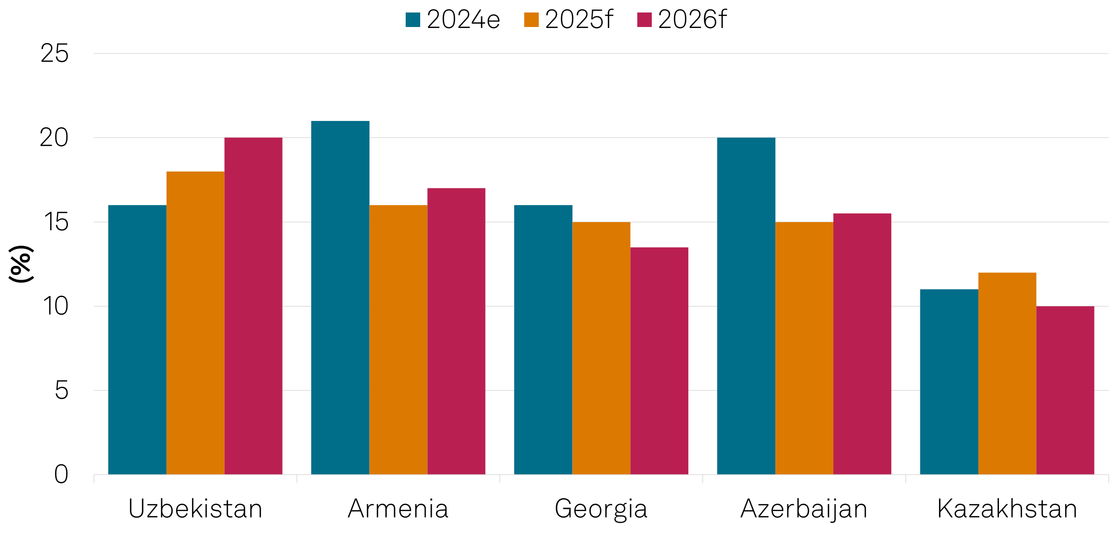
e--Estimate. f--Forecast. Source: S&P Global Ratings.

- Actual GDP growth in the region in 2024 outperformed our forecast.
- We forecast GDP growth in 2025 will be solid but less pronounced than in 2024.
- The deceleration in economic growth for Armenia and Georgia reflects a moderation in the inflow of migrants and capital from Russia.
- Oil producers Kazakhstan and Azerbaijan benefit from recent oil price dynamics but face declining oil production. Positively, non-oil-related growth in these countries exceeds growth in the oil and gas sector.
- Public investments and private consumption boost solid economic growth in Uzbekistan.

Solid Growth In Credit And House Prices Adds To Potential Imbalances

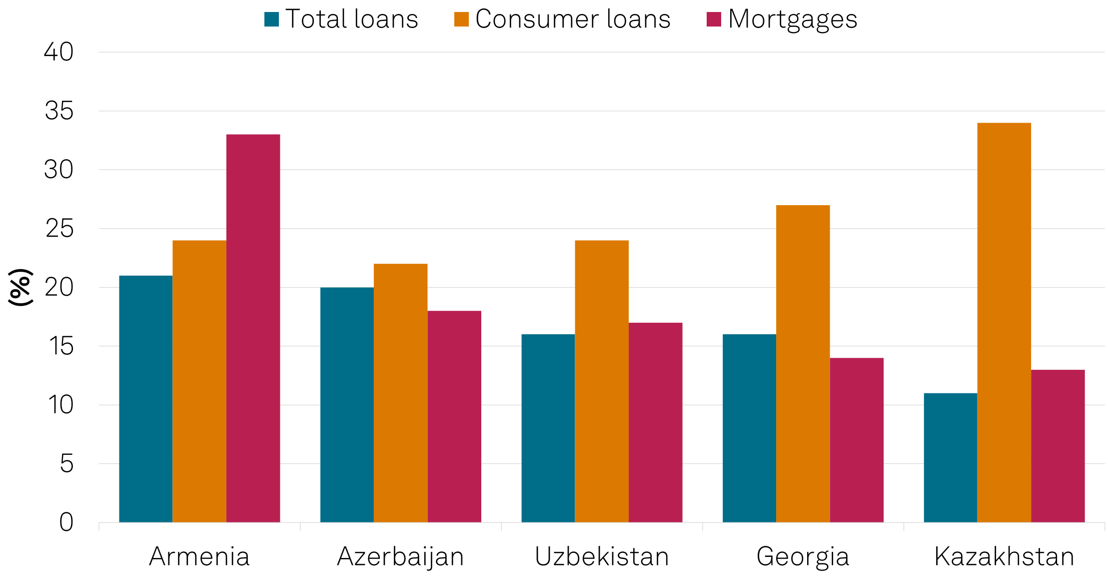
- Rapid lending growth in the region, largely spurred by retail lending, will support banks' profitability but could impair asset quality over the longer term.
- Strong housing price dynamics could evolve as a material risk for banking sectors in Armenia, Georgia, and Azerbaijan. Mortgage lending in the region benefits from local currency government support programs and improving underwriting standards.
- Fast-growing unsecured consumer loans are a particular concern, given the higher risk involved. Stricter regulatory initiatives for retail loans have, to some extent, reduced retail lending growth in Uzbekistan, while retail growth in Armenia, Georgia, and Azerbaijan remains strong.

Credit growth will remain strong in 2025



e--Estimate. f--Forecast. Source: S&P Global Ratings.

Retail lending spurred overall lending growth in 2024



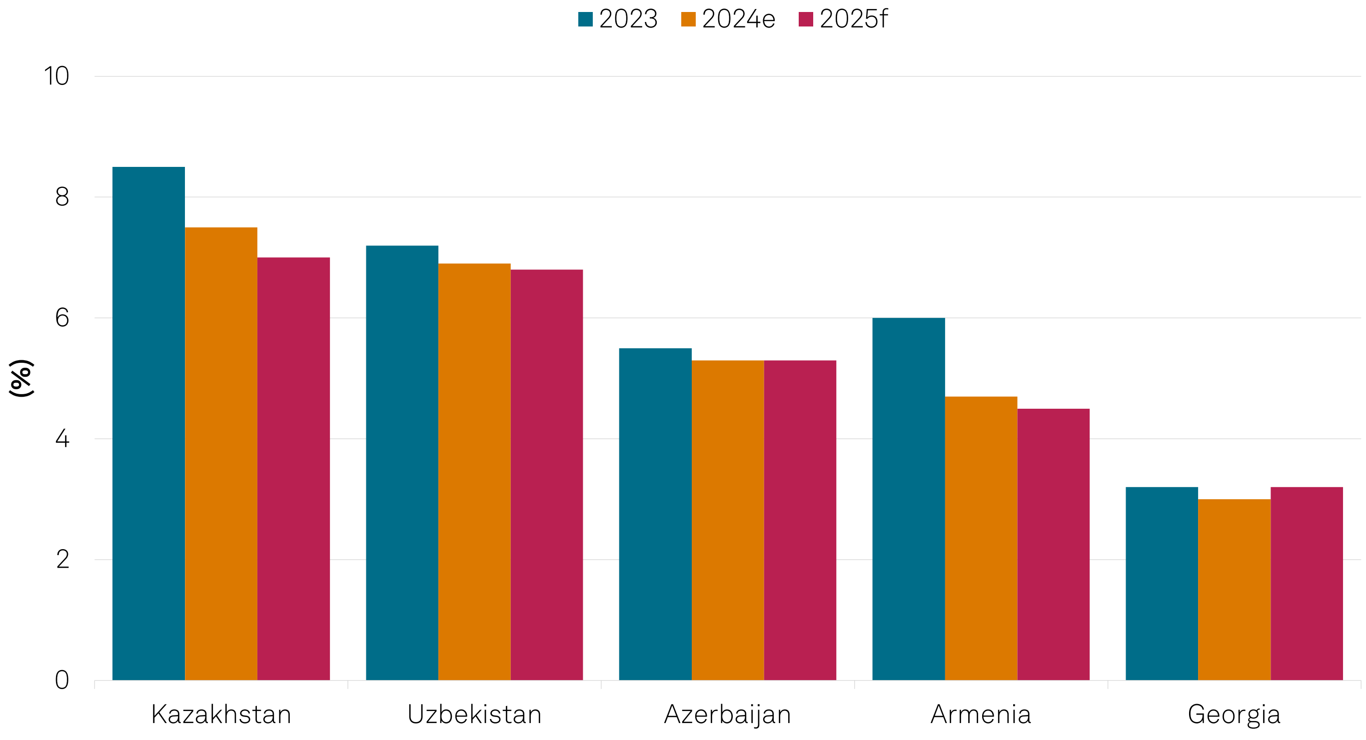
Source: S&P Global Ratings.

Asset Quality Will Remain Resilient

Supportive macroenvironment and solid lending growth will help banks maintain stable asset quality

Share of stage 3 loans will likely remain stable in 2025

Based on S&P Global Ratings' estimates



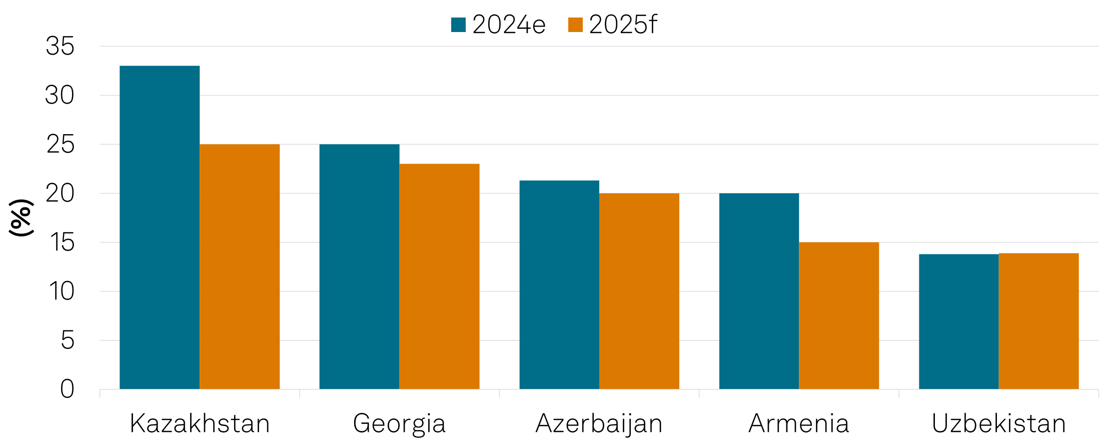
e--Estimate. f--Forecast. Source: S&P Global Ratings estimate.

- Banks' stable asset quality will benefit from supportive macroeconomic conditions and still solid lending growth, while the gap between the strongest and weakest banks will remain.
- Banks that expanded aggressively--especially in higher-risk segments, such as unsecured consumer lending, state banks that are excessively involved in substantial directed lending, and banks with weaker underwriting and risk management systems--will likely see a more pronounced asset quality deterioration, compared with peers.
- The discrepancy between problem loans reported under local standards and those reported under international financial reporting standards (IFRS) will likely remain in most countries of the region and will continue distorting the true asset quality picture in these markets.

Profitability Indicators Will Remain Solid

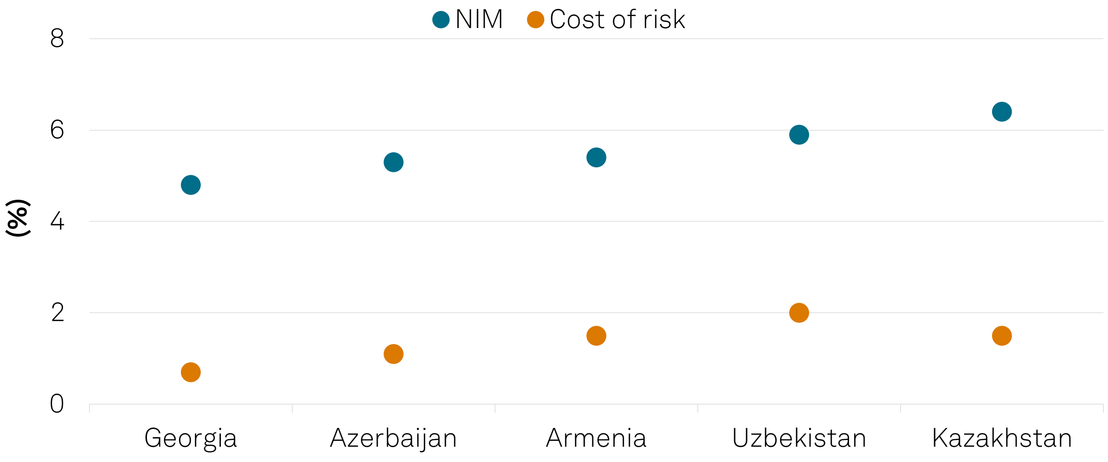
- Profitability will benefit from a lower cost of risk, compared with the average cost of risk over the cycle, and stable asset quality indicators.
- We expect a slight decline in net interest margins of 10-30 basis points (bps) over the next 12-24 months, largely reflecting increasing competition. A rise in the share of higher-margin consumer and small and midsize enterprise (SME) loans will, to some extent, reduce the pressure. Central banks' key refinancing rates have had a limited effect on lending and term deposit rates in local currency in the region over the past five years.
- While investments in digitalization, automation, and cyber security are critical to ensure that banks can respond efficiently to rapidly changing client needs and challenging environments, improvements in cost efficiency will likely only materialize over the long term.

Expected return on equity will be solid in 2025, albeit below the peak in 2023 and 2024



e--Estimate. f--Forecast. Source: S&P Global Ratings.

Stable cost of risk and strong NIMs strengthen profitability

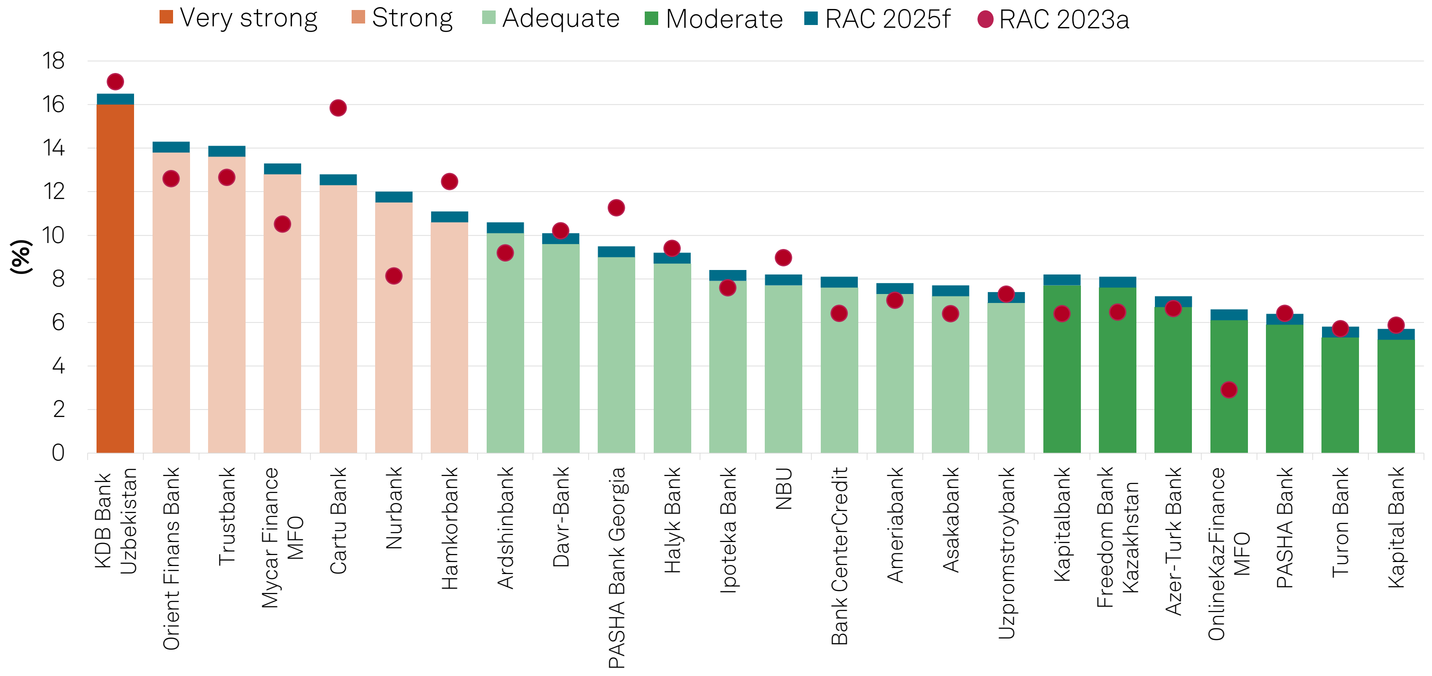


NIM--Net interest margins. Source: S&P Global Ratings.

Capitalization Will Largely Remain Stable

Capital and earnings assessments will likely remain stable in 2025 for most banks

Forecasted 2025 RAC ratios compared with actual RAC ratios in 2023



The legend shows the respective capital and earnings assessments of banks, as per our financial institutions criteria. a--Actual. f--Forecast. RAC--Risk-adjusted capital. Source: S&P Global Ratings.

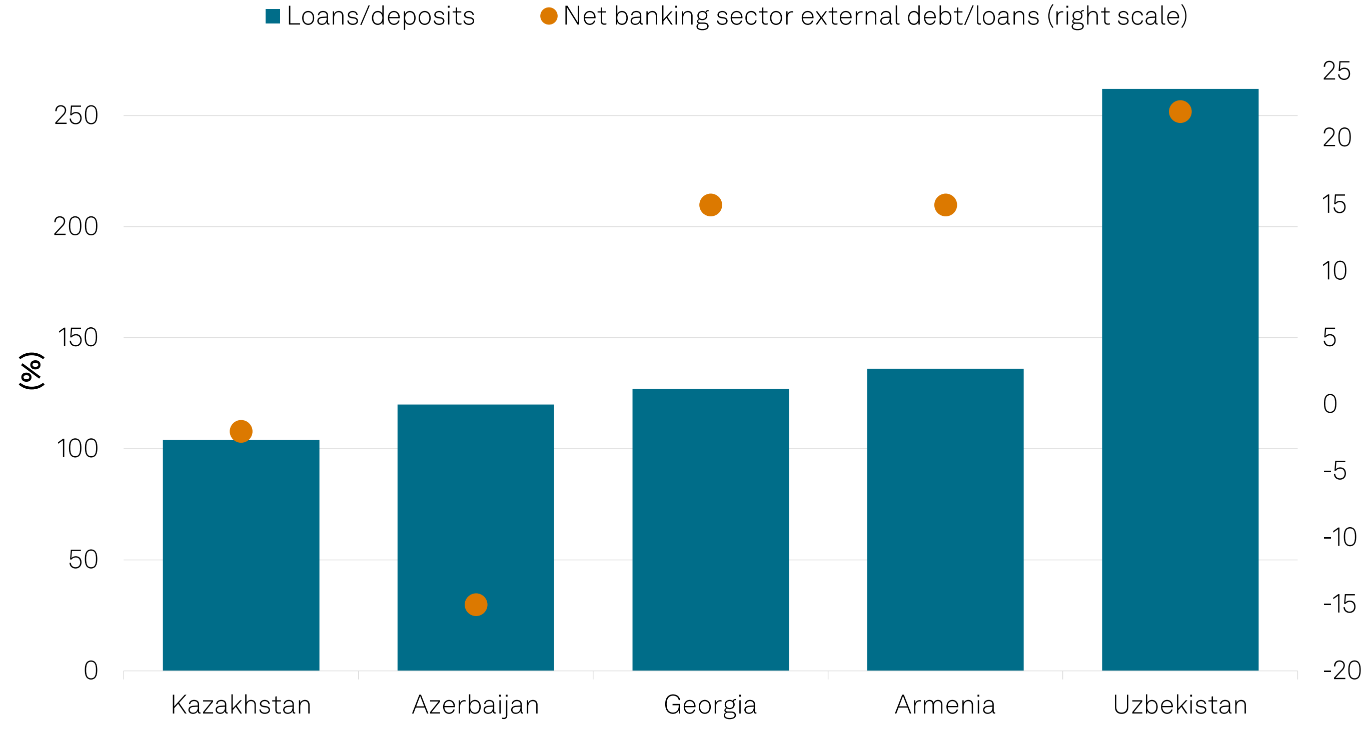
- Larger and more established players are better positioned for continued strong lending growth and regularly pay dividends to shareholders. Smaller banks, on the other hand, depend on capital injections from shareholders to finance growth.
- Banks' core capital mainly comprises tier 1 capital, while the use of hybrid capital instruments is limited.
- Capitalization reported under local regulatory requirements will continue to exceed our risk-adjusted capital (RAC) assessments due to differences in the calculation of asset risk weights and the treatment of tier 2 capital.

Banks' Funding Base Will Remain Stable

Non-resident deposit inflows reduced but will likely show limited volatility

Domestic deposits represent a material funding source, except for Uzbekistan

Data as of year-end 2024



Source: S&P Global Ratings.

- Stable funding translates into manageable funding risk for the region's banking sectors.
- Domestic deposits, government funding, and funding from international financial institutions are the main funding sources for banking sectors in the region and will benefit from the positive macroeconomic momentum.
- While the volume of non-resident deposit inflows in the region has decreased from the peak in 2022 and 2023, we expect it will remain in line with 2024. We expect these deposits will remain stable even in the case of a ceasefire in Ukraine.
- The issuance of eurobonds will likely be immaterial as access to external capital markets will remain limited.

Banking Regulation And Supervision Still Lag Best Practices

- In our view, Georgia has historically demonstrated stronger regulation and supervision than regional peers. However, since 2023 there are signs of a slowing reform momentum, less strict checks and balances between institutions, and weakened policy predictability. The risk exists that the weakening of institutional checks and balances could impair banking sector regulation.
- Central Bank of Armenia has been actively using macroprudential instruments, most recently increasing countercyclical buffer to 1.75% from May 1, 2025. Pillar II is still being implemented. A systemwide supervisory review and evaluation process (SREP), the resolution law, and legislation on perpetual debt are planned to be implemented in 2025.
- In Kazakhstan, we have observed tangible measures over the past few years that point to a durable strengthening of the Kazakhstani financial regulator's oversight and control framework.
- Several initiatives to modernize the regulation and supervision of financial institutions in Azerbaijan were introduced over the past two years under the Financial Sector Development Strategy for 2024-2026.
- In Uzbekistan, state-owned banks continue dominating the sector, while government influence continues to undermine confidence in bank supervision. Meaningful progress on privatization plans and the entry of strategic foreign investors could improve decision-making, regulation, and supervision in the sector.

Banking Industry Country Risk Assessments (BICRAs)

Overall, BICRAs still show high risk levels for banks operating in the region.

- Predominantly stable economic and industry risk trends across the region indicate our expectation of an overall supportive macroenvironment.
- The positive industry risk trend in Azerbaijan captures initiatives to modernize the regulation and supervision of financial institutions in Azerbaijan, although from a comparatively low base.
- In 2024, we revised the BICRA of Kazakhstan to group 7 from group 8, reflecting improvements in the financial regulator's oversight and control framework.

BICRAs of Armenia, Azerbaijan, Georgia, Kazakhstan, and Uzbekistan

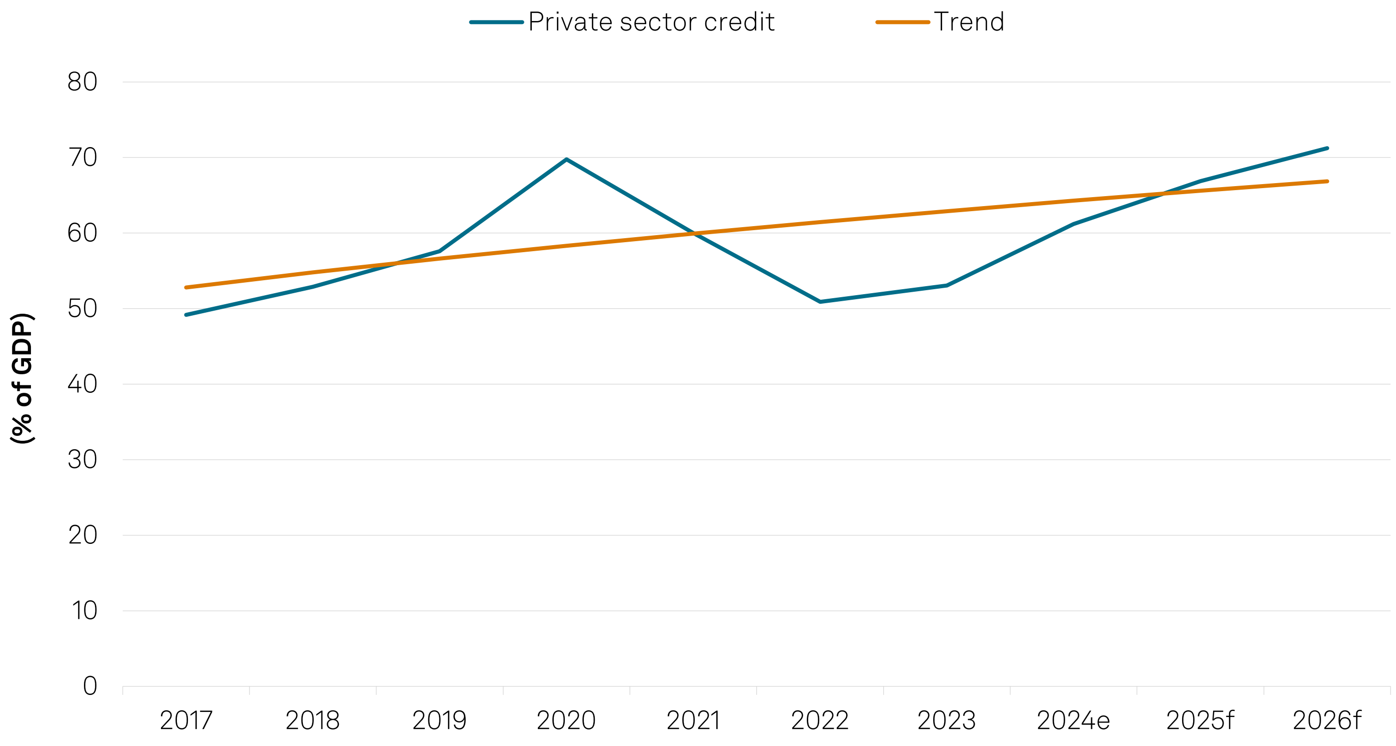
					Economic risk			Industry risk		
Country	BICRA group	Implied anchor	Economic risk/ trend	Industry risk/ trend	Economic resilience	Economic imbalances	Credit risk in the economy	Institutional framework	Competitive dynamics	Systemwide funding
Armenia	8	bb-	7/ Stable	8/ Stable	H	H	VH	VH	H	VH
Azerbaijan	8	bb-	8/ Stable	8/ Positive	VH	H	VH	EH	H	H
Georgia	7	bb	7/ Stable	7/ Stable	H	I	VH	I	H	VH
Kazakhstan	7	bb	7/ Stable	7/ Stable	H	H	VH	VH	H	H
Uzbekistan	8	b+	7/ Stable	9/ Stable	VH	I	VH	EH	H	VH

Positive economic or industry risk trend		Stable economic or industry risk trend		Negative economic or industry risk trend	
Very low risk (VL)	Low risk (L)	Intermediate risk (I)	High risk (H)	Very high risk (VH)	Extremely high risk (EH)

Source: S&P Global Ratings.

Armenia | Leverage in the private sector will continue to increase

Leverage in the private sector will revert to trend levels faster than we anticipated

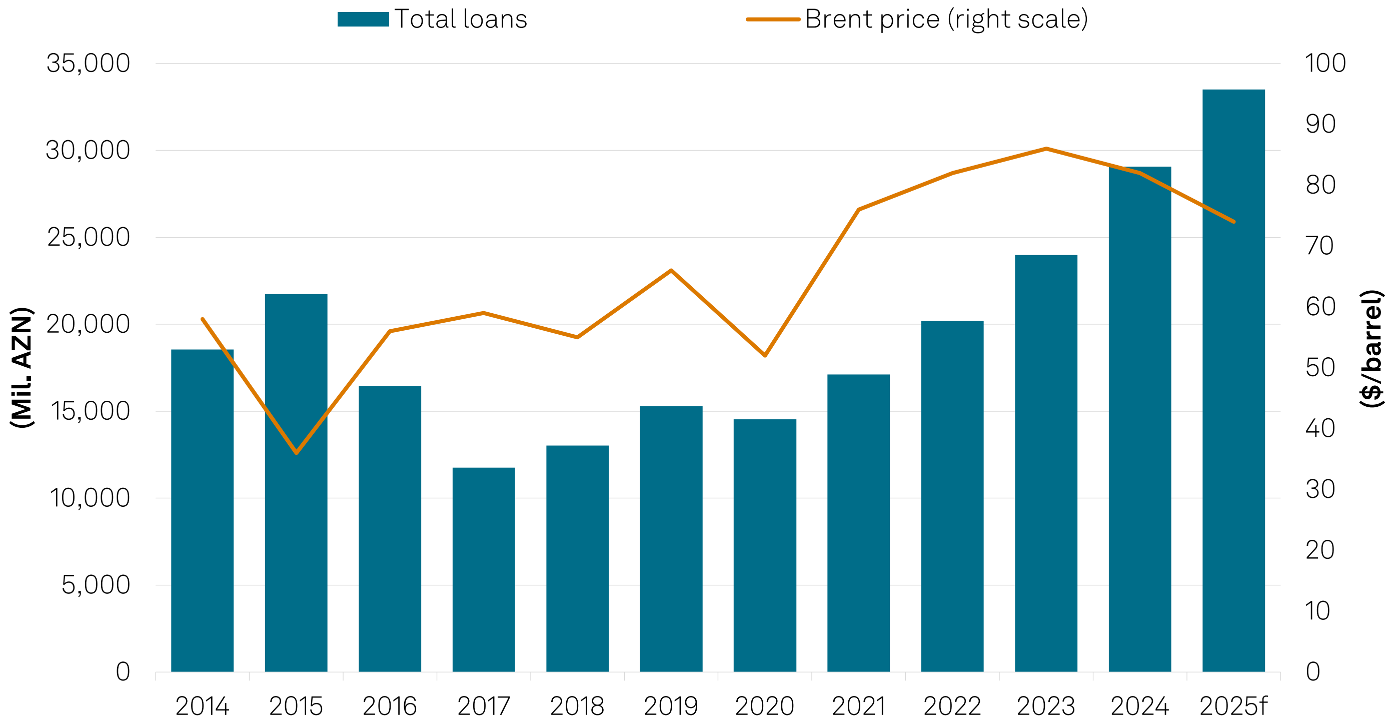


e--Estimate. f--Forecast. Source: S&P Global Ratings.

- Rapid credit growth in 2024 and the projected strong expansion in 2025 mean that Armenia's private sector debt-to-GDP ratio will likely recover to trend levels faster.
- The continued rapid accumulation of leverage, particularly in the household sector with its steadily low savings rate, remains a long-term concern.
- Positively, growth in house prices in Armenia's capital Yerevan slowed to about 6% in 2024. We expect the reduction in the mortgage tax credit size from 2025 will reduce lending growth further.
- Banking sector profitability will continue to normalize due to a stronger base effect, lower foreign currency revenues, and lower global interest rates. We expect returns on assets will decline to about 2.1% on average.

Azerbaijan | Rapid growth in credit and house prices could lead to imbalances

Credit growth is correlated with oil prices

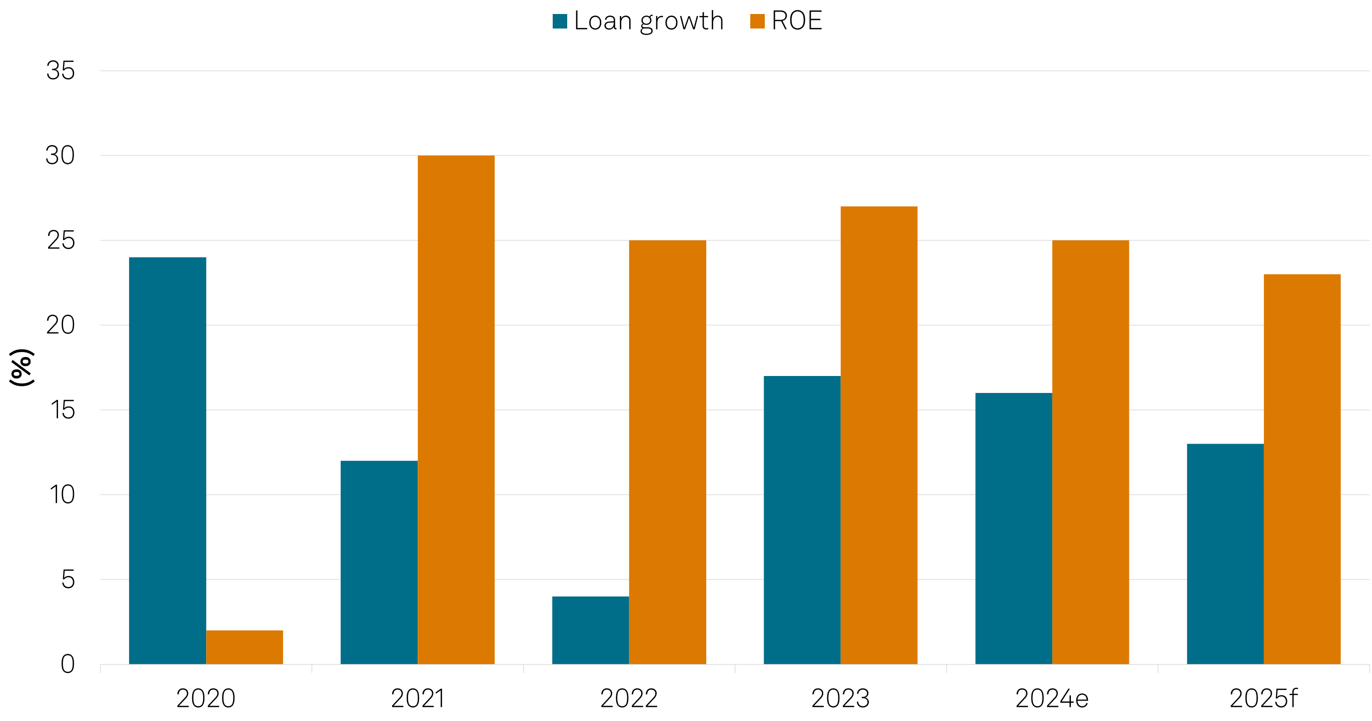


AZN--Azerbaijani manat. f--Forecast. Source: S&P Global Ratings.

- Historically, credit growth in Azerbaijan has been highly correlated with oil prices.
- We forecast loan growth of about 15% in 2025, following an average annual growth rate of 18% in 2021-2024, spurred by high growth rates in consumer loans.
- We forecast that inflation-adjusted house prices will increase by about 5%-10% in 2025.
- Nevertheless, private sector leverage in Azerbaijan remains the lowest among peers, with household debt to GDP of 14% and corporate debt to GDP of 10%.
- From March 1, 2025, the central bank will require an additional counter-cyclical capital buffer of 0.5%, considering that the credit gap indicator (the deviation of the credit-to-GDP ratio from its long-term trend) exceeds 2%.

Georgia | The largest banks expand abroad and must meet MREL requirements

Georgian banks show good profitability over the cycle

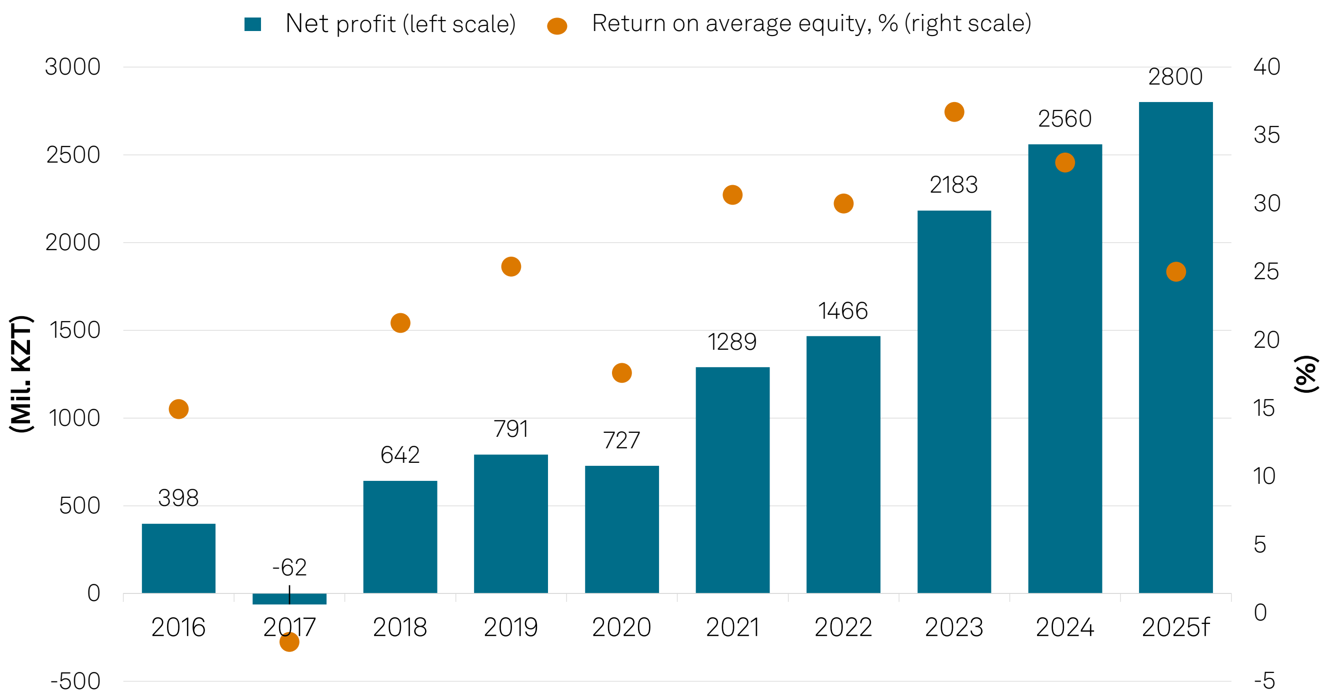


e--Estimate. f--Forecast. ROE--Return on equity. Source: S&P Global Ratings.

- Georgian banks will likely continue showing higher risk appetites than peers and higher profitability through the cycle. The average growth in 2015-2024 was 15%, while return on equity was about 20%. Higher-risk SMEs and unsecured retail loans recorded particularly strong growth.
- The two largest banks have outgrown their home markets and actively search for opportunities abroad, including to riskier countries: TBC Bank in Uzbekistan and Bank of Georgia in Armenia.
- We expect Georgia, as the pioneer in the region, will continue developing the resolution framework to align it with the Bank Recovery and Resolution Directive in Europe.
- In 2024, Georgia introduced minimum requirements for own funds and eligible liabilities (MREL) for the largest three banks (10%, 15%, and 20% by 2024, 2026, and 2028), which are currently met with mainly CET1 capital. The two largest banks issued the first additional tier 1 instruments in 2024 to meet MREL requirements.

Kazakhstan | Banks' profitability remains solid, even though growth is decelerating

Net profit and ROE will remain solid, while the profitability growth peak has likely passed

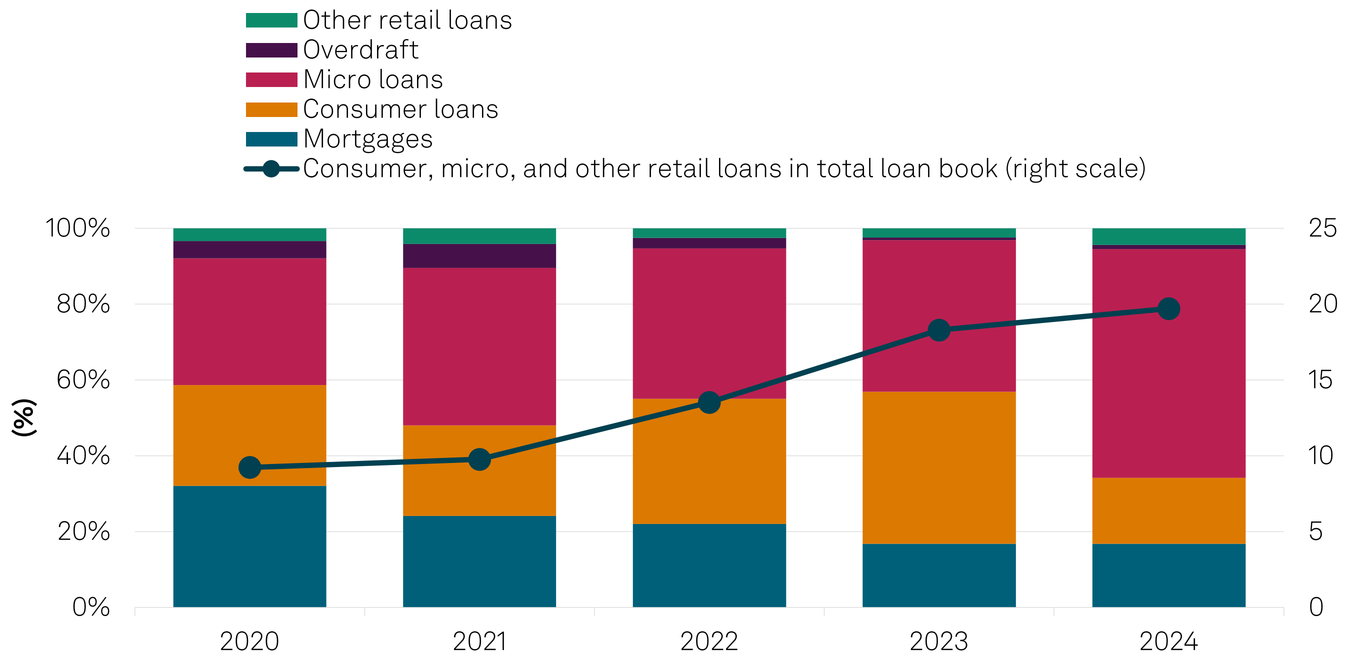


e--Estimate. f--Forecast. KZT--Kazakhstani tenge. Source: S&P Global Ratings.

- We expect Kazakhstani banks will continue benefiting from solid margins that support their earnings generation. Good profitability aids the creation of buffers against potential risks in an uncertain and volatile environment.
- To support margins, banks shifted their business focus toward retail banking in the past three years. Retail loans comprised 60% of total loans at year-end 2024. Net interest margins have expanded by about 150 bps since 2021 to an average of 6.4% in 2024.
- We consider banks' credit risk is currently under control. While we expect retail growth will slow to 18%-20% in 2025, it will remain the major lending growth driver. Less aggressive growth will support banks' risk profiles, while rapidly increasing indebtedness among less-affluent households could increase banks' credit costs during a credit cycle downturn.

Uzbekistan | Strong growth appetite and evolving risk management will test banks' growth models

The growth of consumer loans and microloans shifts loan portfolio compositions to higher-risk segments



Source: S&P Global Ratings.

- Banks will continue expanding their unsecured consumer and SME lending to achieve higher margins. Measures introduced by the regulator since 2023 reduced very aggressive retail lending to about 20% in 2024, from about 50% over the previous years.
- Aggressive growth, tighter competition (including the emergence of more active foreign players), and the still evolving risk management culture will eventually test banks' asset quality.
- The sector remains dominated by state-owned banks, which control about 70% of total assets. We consider that the ambitious privatization agenda will take time and require efforts as state-owned banks will need to transform to improve their performance and become attractive to foreign investors.
- The challenges the sector will face over the next two years include low financial inclusion and low household incomes.

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- Various Rating Actions On Kazakhstani Financial Institutions On Regulatory Oversight And Performance; Outlooks Stable, Dec. 12, 2024
- Banking Industry Country Risk Assessment: Georgia, Oct. 22, 2024
- Banking Industry Country Risk Assessment: Armenia, May 16, 2024
- Banking Industry Country Risk Assessment: Uzbekistan, March 12, 2024
- Banking Industry Country Risk Assessment: Azerbaijan, Feb. 20, 2024

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