Kazakh Banks Datawatch 2Q20

This commentary accompanies financial information derived from the regulatory filings of 24 Kazakh banks to the National Bank of Kazakhstan (NBK) and additional information. It focuses on developments in 2Q20.

Asset Quality Weakens

In 2Q20, the Kazakh banking sector experienced the first phase of loan-quality deterioration, driven by the economic consequences of the COVID-19 pandemic and lower oil prices.

In 2Q20, sector recurring loan impairment charges (LICs) rose to 3% (annualised) of average loans, up from 2% in 1Q20 and 1.5% in 4Q19. We believe there may be significant time lags on loan impairment recognition and expect asset quality to stay under pressure in the medium term.

Currently, the banks are allowed not to recognise certain loans as impaired due to available regulatory forbearance. According to NBK representatives, from March 2020, 34% of retail and 41% of SME borrowers applied for payment holidays. Fitch Ratings estimates this to make up about 15% of sector loans. We believe banks may have to gradually absorb additional LICs on some of these exposures after regulatory forbearance expires.

However, banks' overall asset quality benefits from a favourable asset structure: at end-2Q20, net loans were just 47% of sector assets, while non-loan exposures are of sound credit quality.

Reasonable Resilience Remains

In 2Q20, sector average pre-impairment profit stayed stable, at 9.5% of average loans (annualised), providing most banks with strong loss-absorption capacity. Solid capital and liquidity buffers also support the resilience of the Kazakh banking sector to stress. At end-2Q20, the sector Tier 1 ratio and gross loans/deposits ratio remained comfortable at 21% and 78%, respectively.

Nurbank Received Capital Support

In 2Q20, Nurbank received a KZT20 billion capital contribution from its private shareholders and about KZT30 billion of fair-value gains on low-rate subordinated debt received from the NBK. Combined, this was equal to 17% of the bank's regulatory risk-weighted assets. This capital was used to create provisions on legacy problem assets, as revealed by the regulatory asset-quality review (AQR) earlier this year.

At end-1Q20, Nurbank's loan-loss allowance was 12% of gross loans and in 2Q20 the bank booked additional LICs equal to 20% of average loans. However, according to IFRS 9 disclosures, at end-2019, Nurbank's Stage 3 loans ratio was a high 49%, so further provisioning may be required, in Fitch's view.

LICs at Other Banks Are Reasonable

Apart from Nurbank, several other banks booked higher LICs in 2Q20. These were Eurasian (8.7% of average loans, annualised), Jysan (8.5%), Tengri (6.5%), Sberbank (6.4%) and Centercredit (6.0%). However, most of these impairment losses may be largely related to legacy assets and do not point to the magnitude of emerging problems in new lending.

Annexes

Kazakh Banks Datawatch 2Q20 (Excel) (August 2020)

Related Research

Fitch Affirms Kazakhstan at 'BBB'; Outlook Stable (February 2020)

CIS & Black Sea Region: High Fiscal Financing Needs, Limited Near-Term Pressures (July 2020)

Emerging Market Banking System Datawatch: End-2019 (July 2020)

Analysts

Dmitri Vasiliev
+7 495 956 5576
dmitri.vasiliev@fitchratings.com

James Watson
+7 495 956 6657
james.watson@fitchratings.com

Pavel Kaptel
+7 495 956 9981
pavel.kaptel@fitchratings.com

Stable Performance, but LICs May Increase

In 2Q20, 19 out of 24 Kazakh banks remained profitable, including all major banks (except for Jysan), although some pressures on revenues are emerging. The banks' non-interest income dropped by 30% and the net interest margin reduced by 20bp (to 6.3%) over the quarter. However, overall pre-impairment profit largely remained stable, covering a high 9.5% of average loans.

In Fitch's view, sound pre-impairment profits should be sufficient to cover the expected uptick in LICs at most banks. However, there are a few weaker banks that have entered the current crisis with significant unresolved legacy problems. These banks' loss-absorption capacity is weaker compared with the sector average.

IFRS 9 Metrics Disclosed

According to IFRS 9 disclosures, at end-2019, some of the 10 largest Kazakh banks continue to have sizeable unreserved problem assets. In our view, the recent AQR did not reveal the entire amount of problem loans, so in addition to potentially higher LICs in new lending, banks may have to absorb extra impairment on legacy exposures, as these will now be harder to recover.

At end-2019, the average Stage 3 and Stage 2 loan ratios were 20% and 5%, respectively, down from 22% and 7%, respectively, at end-2018. The IFRS 9 loan-quality ratios are twice higher than the regulatory impaired loans ratio (11% at end-2Q20), meaning that some problem loans remain unrecognised in regulatory accounts.

Slight Increase of Capital Ratios

In 2Q20, the sector Tier 1 capital ratio increased by 150bp (to 20.9%) due to profit retention and a 5% risk-weighted assets contraction. The latter was driven by a nominal reduction of gross loans by 2.5% and also by regulatory forbearance, as certain risk-weights were temporarily lowered. The sector average Tier 1 ratio may reduce by 100bp, as Halyk declared KZT200 billion of dividends (equal to 60% of 2019 net income under IFRS 9) to be payable in 2020.

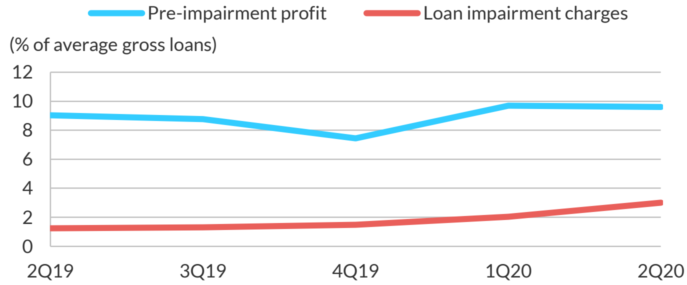
At end-1Q20, the lowest Tier 1 capital ratios were reported by Centercredit (10.2%), ATF (10.6%) and Eurasian Bank (11.4%). These capital ratios are modest, in Fitch's view, given that all three banks have weaker performance and asset quality compared with sector averages.

Moderate Deposit Growth; Strong Liquidity

Adjusted for foreign-currency moves, sector gross loans were flat in 2Q20 and deposits increased by 6%. After an 18% depreciation in 1Q20, the Kazakh tenge showed a moderate 10% appreciation in 2Q20, thereby supporting depositor confidence. Loan and deposit dollarisation ratios remained stable, at 16% and 41%, respectively, at end-2Q20.

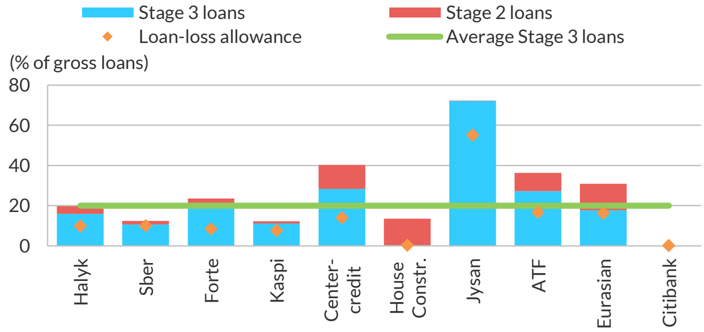
At end-2Q20, liquid assets covered a high 55% of sector liabilities and liquidity positions were strong at almost all Kazakh banks, except for two very small banks (Tengri and AsiaCredit), which have a combined 0.5% market share.

Loss-Absorption Capacity



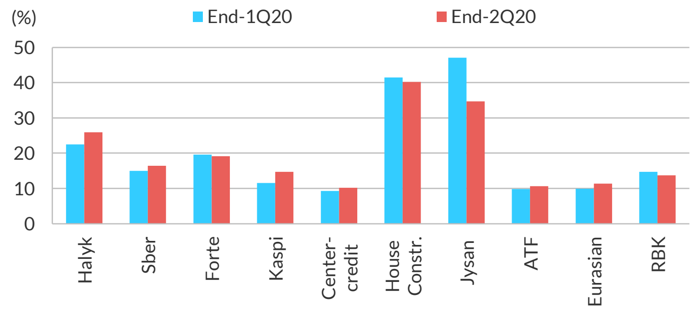
Annualised, where appropriate. LICs are adjusted for Jysan Bank and Nurbank.
Source: Fitch Ratings, NBK, regulatory accounts

IFRS 9 Asset-Quality Metrics, End-2019



Source: Fitch Ratings, Banks' IFRS accounts

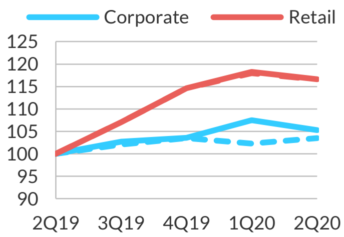
Tier 1 Capital Ratio (k1-2)



Source: Fitch Ratings, NBK, regulatory accounts

Loan Growth

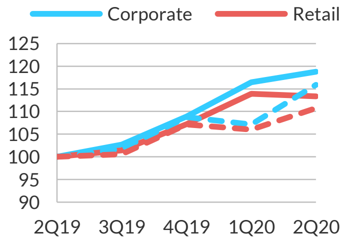
(2Q19 = 100)



Dashed lines reflect growth rates adjusted for foreign-exchange changes.
Source: Fitch Ratings, NBK, regulatory accounts

Deposit Growth

(2Q19 = 100)



Dashed lines reflect growth rates adjusted for foreign-exchange changes.
Source: Fitch Ratings, NBK, regulatory accounts

Appendix

Source and Scope of Information

The data in this report, and the accompanying excel file, are based primarily on unaudited filings made by Kazakh banks to the NBK and the Kazakhstan Stock Exchange (KSE). It is also based on data published on their websites (http://nationalbank.kz/and http://kase.kz/) on monthly and quarterly bases. Foreign-exchange rates and oil price data are published daily by the NBK and Bloomberg, respectively.

Banks' regulatory financial statements, including balance sheets, income statements and off-balance-sheet disclosures, are published by the KSE quarterly. The 24 banks covered in this report and the accompanying excel file comprised over 99% of sector assets at end-2Q20.