Investors scramble for Kazakhstan's euro-denominated bonds

But successful €1.05bn issue leaves little upside at current levels, warn analysts

Kazakhstan is gearing up for big sales in energy and other strategic sectors, says Ruslan Beketayev, the country's vice-minister of finance © Bloomberg

By Jonathan Wheatley
Originally published in The Financial Times, 16th November 2018

Kazakhstan's debut euro-denominated issue of €1.05bn met high demand as investors brushed aside concerns about the country's weakness in areas such as banking and focused on low debt levels and large forex reserves.

The issue marks a "significant milestone" that provides "an additional boost to the national privatisation plan" as Kazakhstan gears up for big sales in energy and other strategic sectors, Ruslan Beketayev, the country's vice-minister of finance, told the Financial Times.

The sale attracted strong investor support. A €525m five-year tranche was sold with a coupon of 1.55 per cent and a 10-year tranche of the same size with a coupon of 2.375 per cent, while the sale as a whole was almost four times subscribed, Mr Beketayev said.

The pricing at issuance last week compares favourably with similarly rated sovereign peers — Kazakhstan is rated at the bottom rung of investment grade by Moody's and S&P Global and a notch higher by Fitch Ratings — and the bonds have since traded above par on secondary markets.

“It’s a good solid story with decent macro fundamentals, and the euro issue came cheap [for Kazakhstan],” said Brett Diment, head of emerging market debt at Aberdeen Standard Investments.

But analysts said Kazakhstan’s solid fundamentals — strong public sector and external balance sheets, low levels of debt and a large stock of foreign currency reserves — were accompanied by structural weaknesses that include a fragile banking sector, poor governance indicators and a high level of dependence on the oil sector. This may leave little upside to the bonds at current levels.

Paul Greer, portfolio manager for EM debt at Fidelity International, said the main risks facing Kazakhstan were “the political succession plan for President [Nursultan] Nazarbayev and indirect fallout from any further escalation of US debt sanctions on Russia”, given the Kazakh economy’s close links to its northern neighbour.

He added that Kazakh bonds trade expensively compared with those of its peers, partly because a dearth of issuance in recent years has supported the market.

Mr Beketayev said that “within the government we have taken many steps to diversify the economy, which is why we believe we are fully prepared for all scenarios, including a fall in the oil price and other negative external economic factors”.

He said the Astana International Financial Centre — designed as a financial hub for central Asia, where 11 per cent of the 10-year bond was sold and where both tranches will be traded on secondary markets — would attract international investment for future bond and equity sales thanks to its use of English law and its financial court for dispute settlement.

He said planned privatisation sales, including initial offers of stakes in uranium producer Kazatomprom, due this month, and oil and gas company KazMunaiGaz, expected next year, would involve dual listings in London and Astana and would help drive diversification and reduce the state’s role in the economy.

But analysts warned that the Kazakh economy remained highly dependent on oil and that persistent weakness in the banking sector, partly a legacy of the tenge’s sharp devaluation in 2015, remained a potential drain on public finances.

One EM strategist who asked not to be named said the AIFC revived memories of a similar project in Almaty, the Kazakh capital, which came to little after “very aggressive” debt restructuring in the banking sector following the global financial crisis.

“It’s hard to see how you can have a financial hub when the banking sector is not working effectively,” he added.

At the previous restructuring, the strategist said “the government had sent a strong message that it would stand behind the banks but when push came to shove, it didn’t, even though it had a strong balance sheet.

“This was a successful bond issue based on the sovereign story, but I’m not sure you can say more than that.”