



Central Asia And The Caucasus Banking Sector Outlook 2024

The Region Withstands Geopolitical Risks

S&P Global
Ratings

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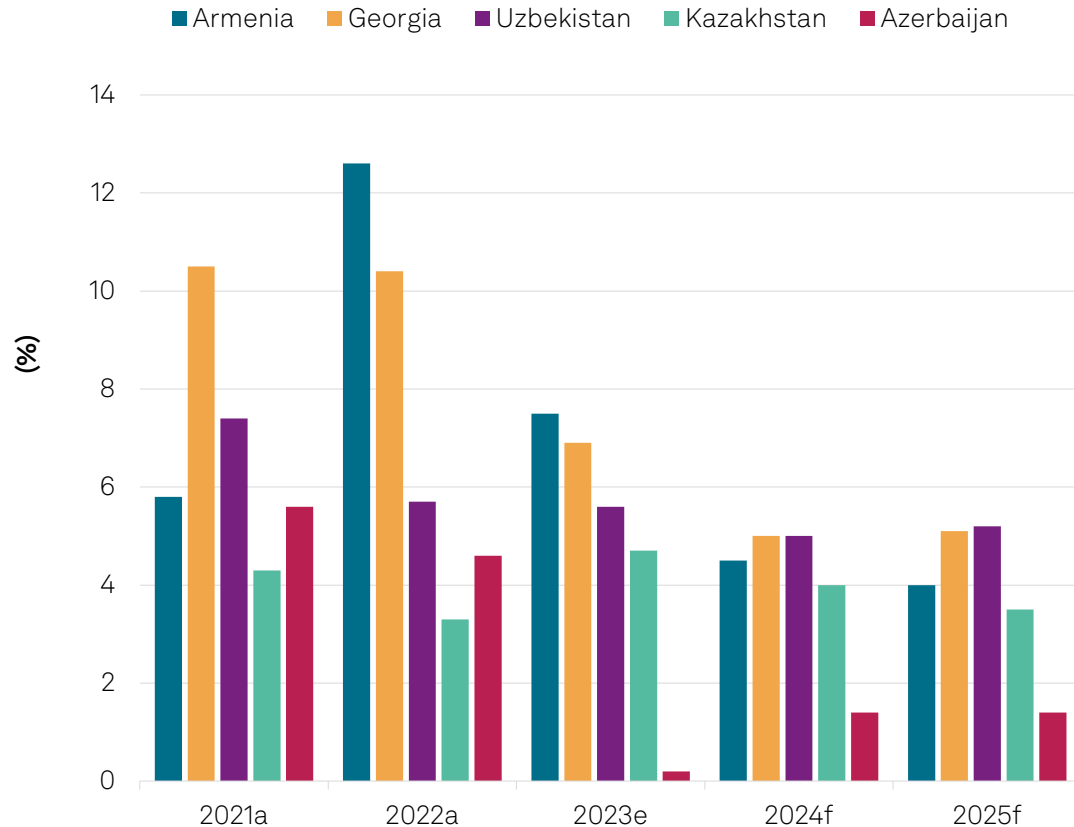
This report does not constitute a rating action

Key Takeaways

- We expect banks' performance in Armenia, Azerbaijan, Georgia, Kazakhstan, and Uzbekistan will remain resilient in 2024, with low double-digit lending growth and stable asset quality supporting profitability and capital levels.
- Favorable economic growth prospects, high demand for lending--especially retail lending--sound funding and liquidity metrics, and stable profitability will support ratings in 2024. As of February 2024, the outlook on 80% of our ratings on banks in the region was stable.
- Key risks include a sharper-than-expected global economic downturn, elevated regional geopolitical tensions, aggressive growth in retail lending, high exchange rate volatility, and slowing de-dollarization.
- Regulation, supervision, and governance of regional banking sectors is evolving but remains less efficient and predictable than in developed markets.

GDP Growth Remains Solid

Real GDP growth



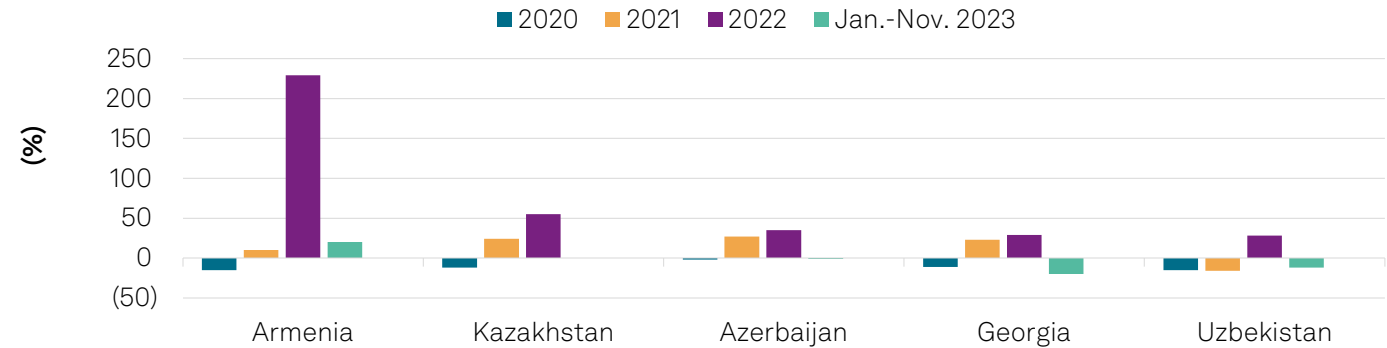
a--Actual. e--Estimate. f--Forecast. Source: S&P Global Ratings.

- After an exceptional increase over 2022-2023, GDP growth in Central Asia and the Caucasus is slowing to a still solid 4% average in 2024.
- High immigration and large capital inflows in Armenia and Georgia reduced in 2023, compared with 2022, but will continue to support economic growth over the medium term. Georgia's economy also benefits from recovery in the tourism sector.
- Oil producers Kazakhstan and Azerbaijan benefit from supportive hydrocarbon prices and, in the case of Kazakhstan, also from increasing oil production. Key vulnerabilities include the countries' economic concentration on the oil sector, ageing oil fields, and declining oil production in Azerbaijan. Tighter fiscal policy limits Kazakhstan's growth additionally.
- Robust domestic demand and investments, coupled with ongoing economic and energy price reforms, support Uzbekistan's economic growth prospects and result in the highest forecast GDP growth in the region over the medium term.

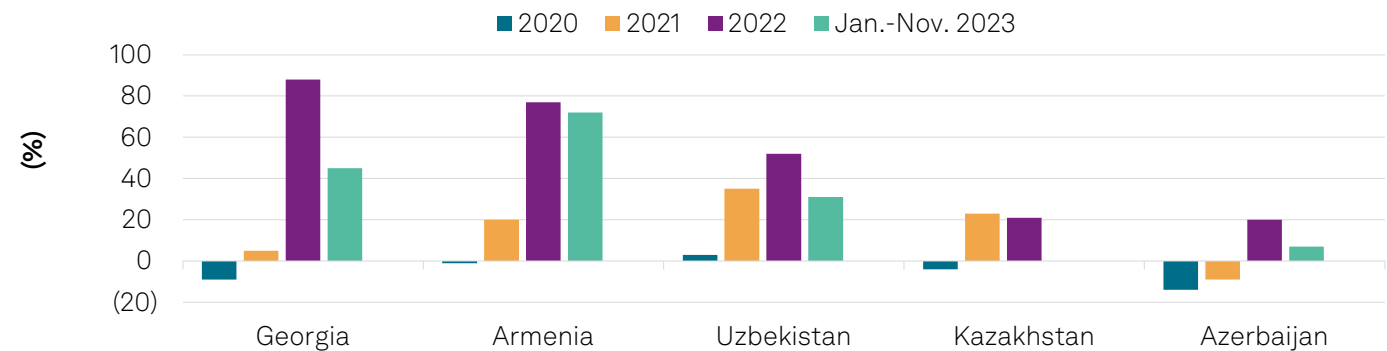
Increasing Trade With Russia Entails Potential Risks

- Central Asia and the Caucasus increased re-exports of goods to Russia in 2022 as Russia aimed to compensate for its inability to import directly from the EU. Russia's share of imports from Central Asia and the Caucasus will continue to exceed pre-conflict levels in 2024.
- Higher trade exposure to Russia has supported and, in some cases, could continue to support growth in the region, especially in the consumer and capital goods re-exporting sectors, food production, tourism, and IT.
- Yet, increasing trade with Russia carries the risk of international sanctions on businesses and banks that are involved in the export of goods that are sanctioned by the EU. It also means that economic growth in Central Asia and the Caucasus is increasingly reliant on Russia, with the added risk of higher exposure to the Russian government's trade policy decisions.

Annual growth of exports to Russia, compared with 2019 (US\$ terms)



Annual growth of imports from Russia, compared with 2019 (US\$ terms)

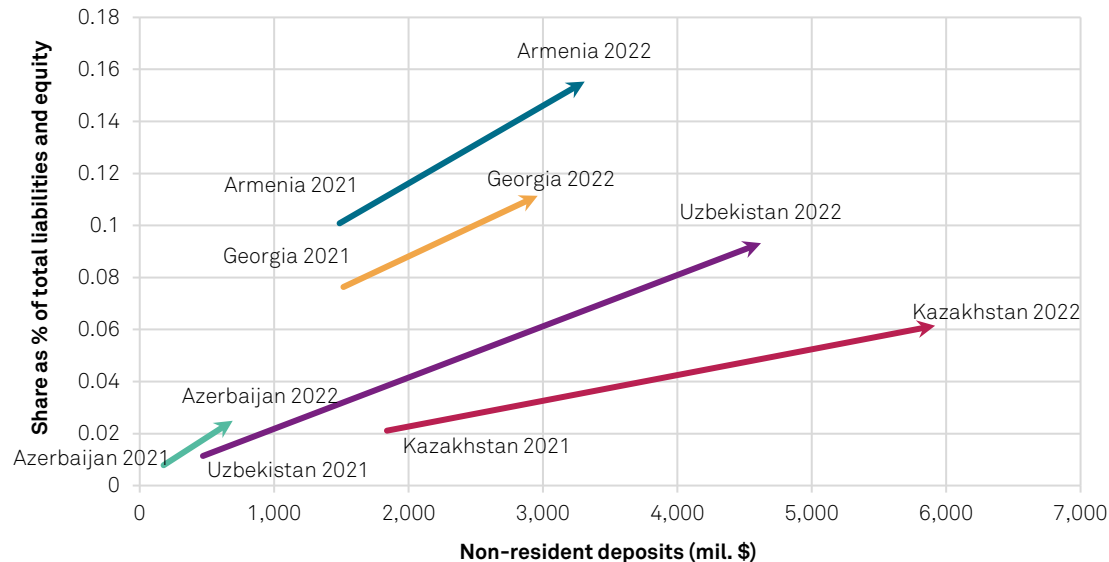


Sources: S&P Global Ratings, Comtrade.

Remittance And Non-Resident Deposit Inflows Normalize

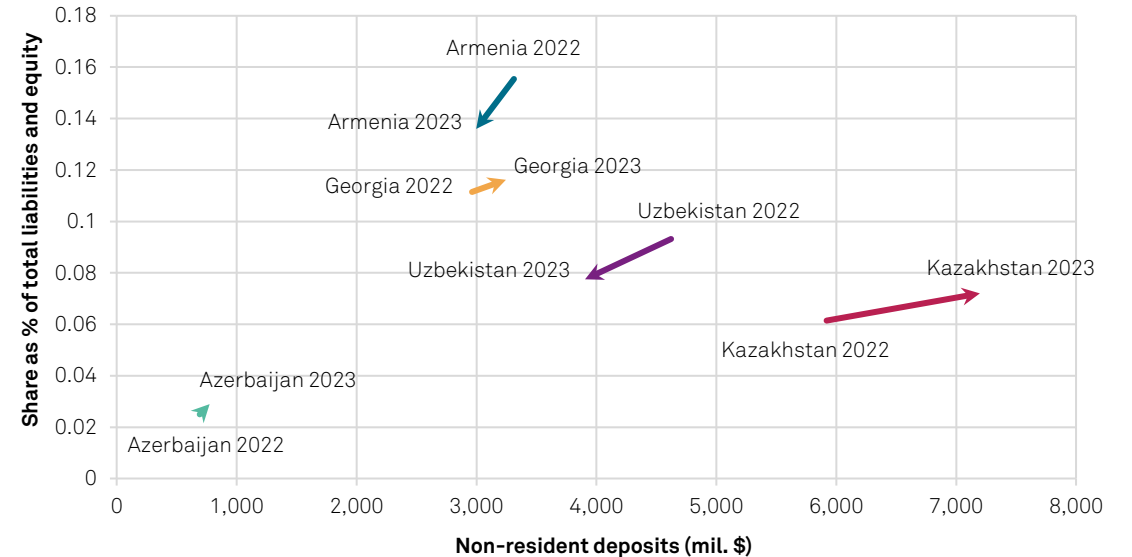
- The Russia-Ukraine conflict caused a peak in remittance and foreign-fund inflows in 2022 and increased market volatility.
- We estimate that Russia accounted for 40%-80% of non-resident deposit and remittance inflows to the region in 2022.
- We expect the volume of non-resident deposit inflows in Central Asia and the Caucasus will largely remain stable in 2024. Therefore, we do not expect an increase in funding risk for the region's banking sectors.

Non-resident deposits increased significantly in 2022...



Source: S&P Global Ratings.

...but their growth rate decreased and even reversed in 2023



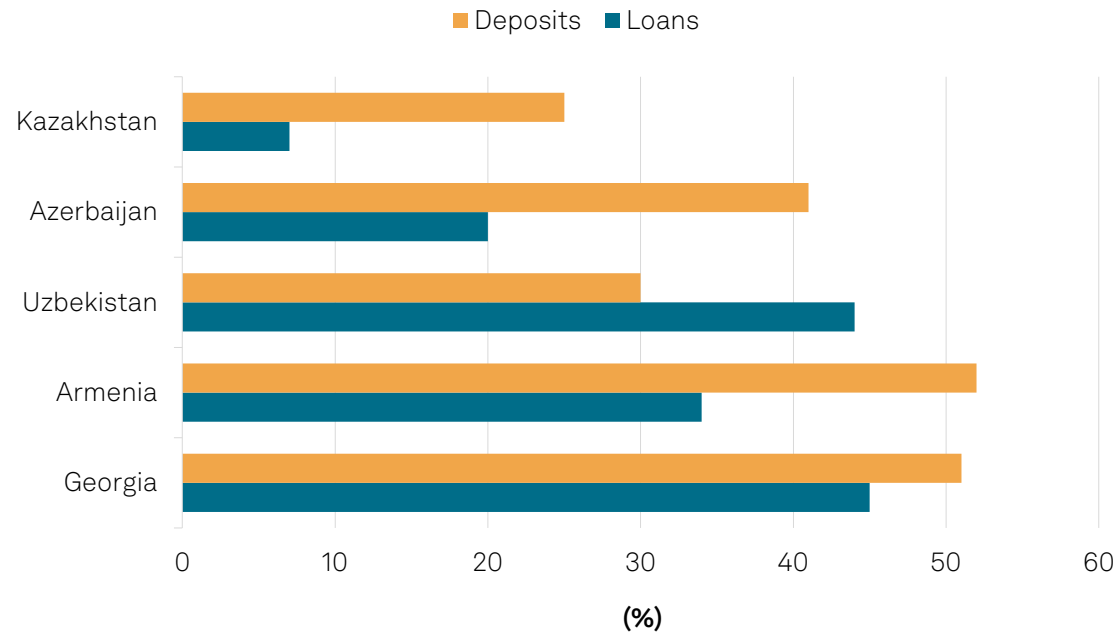
Source: S&P Global Ratings.

High Dollarization Marks A Problem

High dollarization exposes banks' asset quality, profitability, and capitalization to exchange rate volatility. We expect that exchange rate risk will remain elevated and that progress in reducing high dollarization will be limited in 2024. This could increase credit and funding risks for banks and reduce capital positions in case of exchange rate shocks.

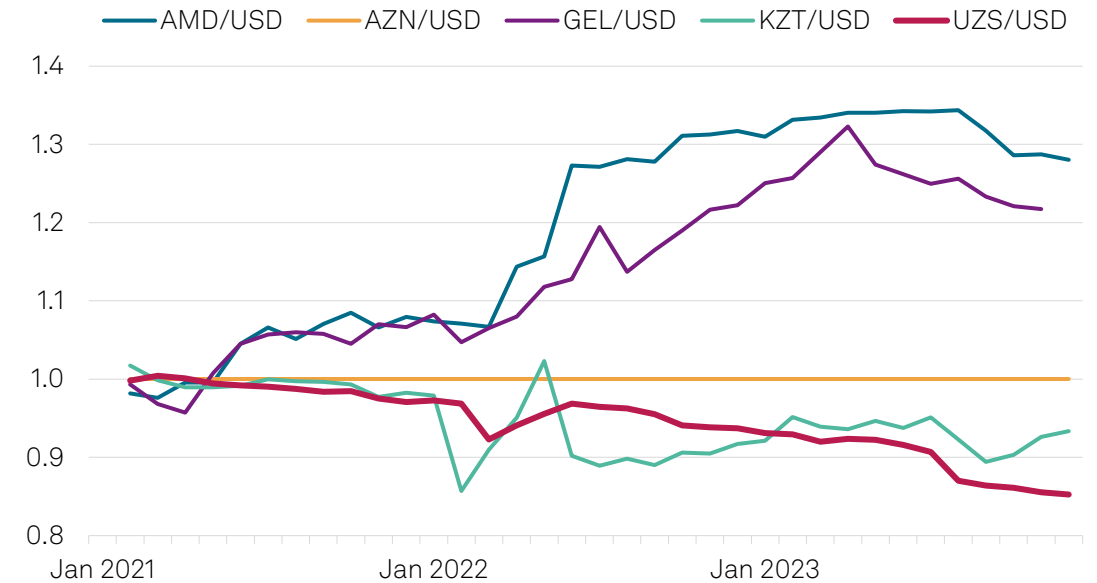
Estimated share of foreign-currency loans and deposits

Data as of year-end 2023



Source: S&P Global Ratings.

Local-currency exchange rate dynamics*

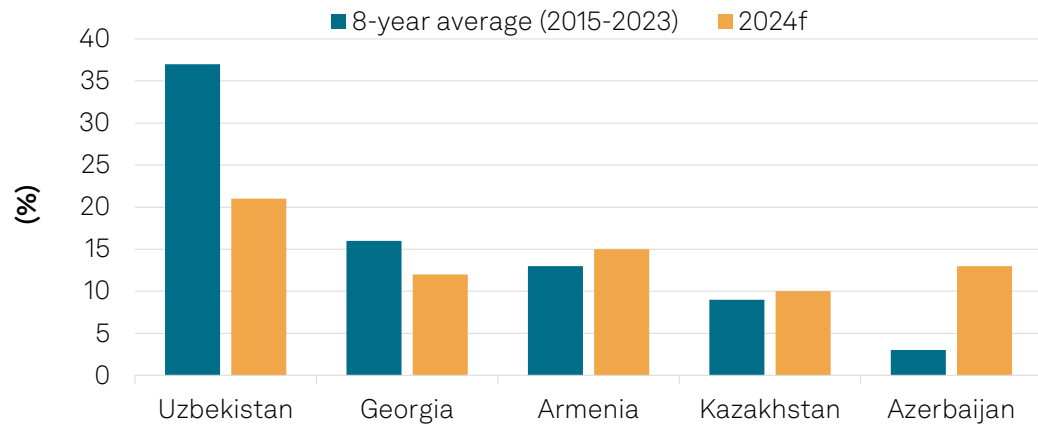


AMD--Armenian dram. AZN--Azerbaijani manat. GEL--Georgian lari. KZT--Kazakhstani tenge. UZS--Uzbekistani sum. *The extent to which GEL and AMD strengthened against USD exceeded that of KZT against USD over 2022-2023; UZS weakened against USD over the same period; AZN is pegged to USD. Sources: S&P Global Rating, Bloomberg.

Rapid Credit Growth Is A Blessing And A Curse

- Strong regional lending growth, which is largely driven by retail lending, will support banks' profitability but might reduce their asset quality.
- We consider that housing price dynamics are not a material risk for regional banking sectors, except in Georgia and Armenia. Mortgage lending in the rest of the region benefits from local-currency state programs and underwriting standards that improve the performance of mortgage loans.
- Fast-growing unsecured consumer loans are a particular concern, given their higher risk profiles.
- We expect regulations on retail loans will tighten further, which will likely slow new consumer loan issuances.

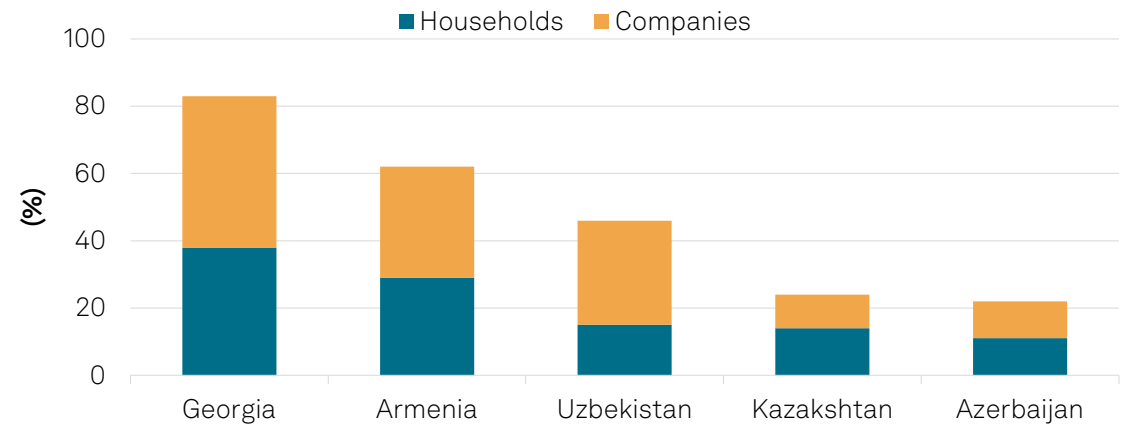
Credit growth will remain strong in 2024



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

Household and corporate debt-to-GDP remain low in an international context

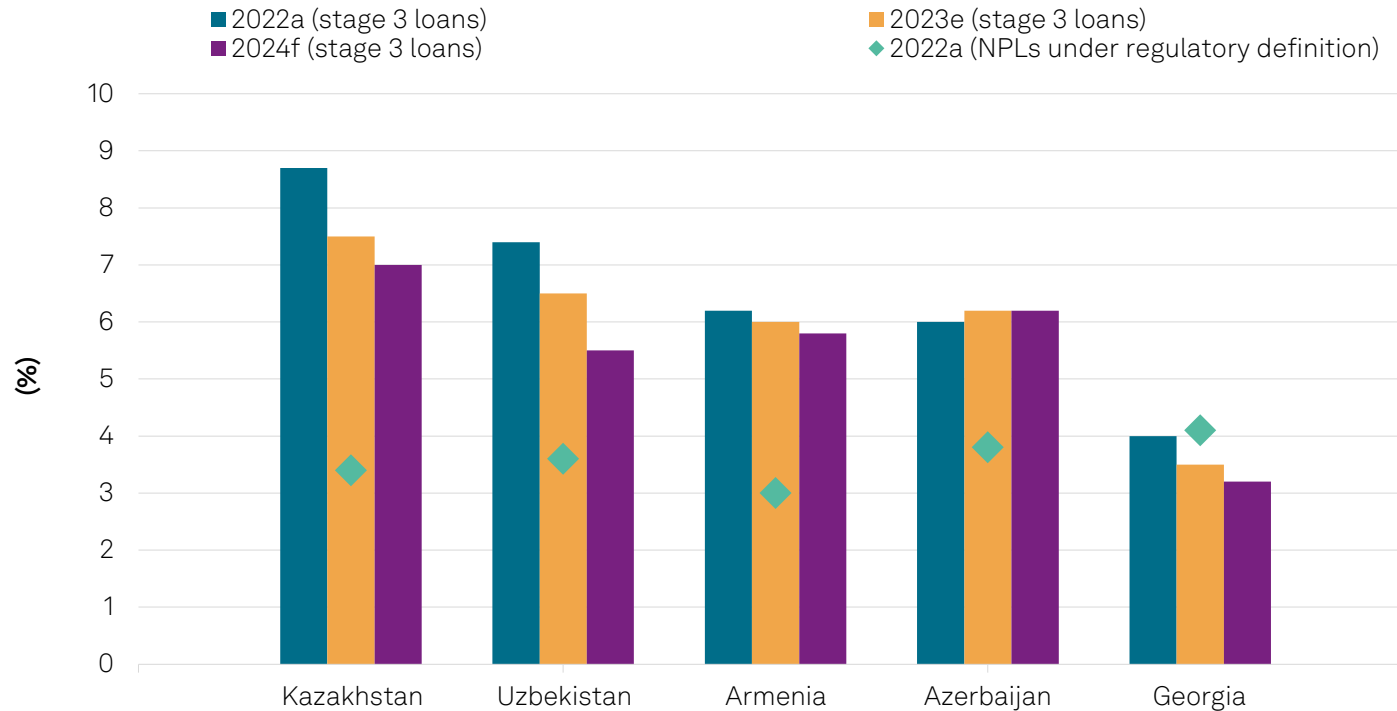
Data estimate as of year-end 2023



Source: S&P Global Ratings.

Asset Quality Will Remain Broadly Stable

Systemwide stage 3 loans



a--Actual. e--Estimate. f--Forecast. NPL--Nonperforming loan. Source: S&P Global Ratings.

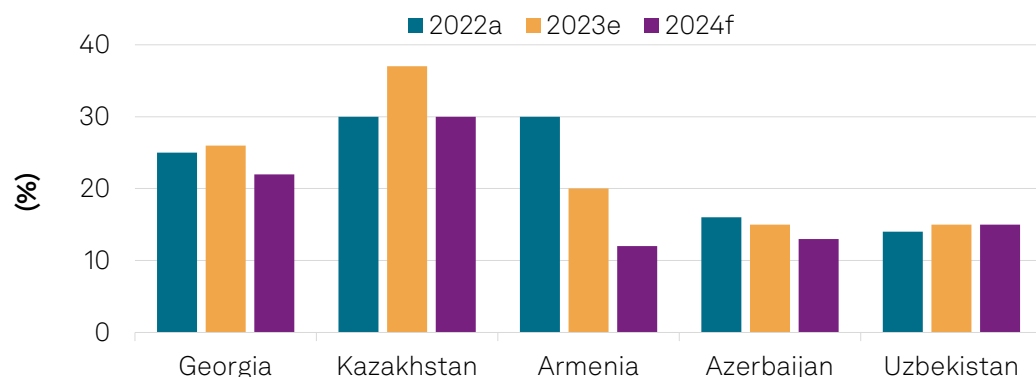
- Banks' stable asset quality will benefit from supportive macroeconomic conditions while the gap between the strongest and weakest banks will remain.
- Banks that expanded aggressively-- especially in riskier segments, such as unsecured consumer lending, state banks that are involved in substantial directed lending, and banks with weaker underwriting and risk management systems will likely suffer from asset quality deterioration, compared with peers.
- The discrepancy between problem loans reported under local standards and under international financial reporting standards (IFRS) will likely remain in most of the region. This somewhat distorts the true asset quality picture in these markets.

Profitability Indicators Reverting To Pre-2022 Levels

- Strong lending growth will support revenue growth while net interest income will remain the main revenue contributor.
- We expect the exceptionally strong growth in fees and commissions over 2022-2023 will recede as currency exchange operations with non-residents reduce. An increase in lending to small and midsize enterprises (SME) and retail customers will increase fees and commissions, in line with the growth trend before 2022.
- Stable asset quality trends will result in a normalization of the cost of risk.
- While investments in digitalization, automation, and cyber security are critical to ensure that banks can respond efficiently to rapidly changing client needs, improvements in cost efficiency will likely only materialize over the long term.

We expect profitability will normalize after extraordinarily strong results over 2022-2023

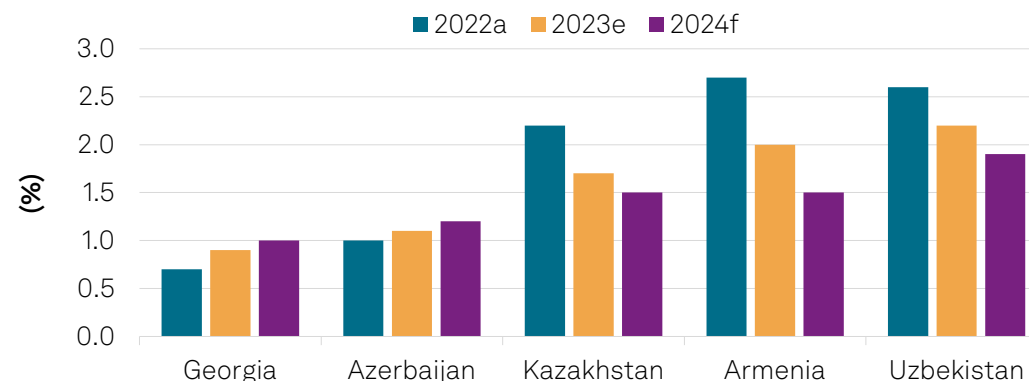
Return on adjusted equity (ROAE)



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

Cost of risk normalizes to an average 1.5%

This reflects expectations that geopolitical tensions will not escalate



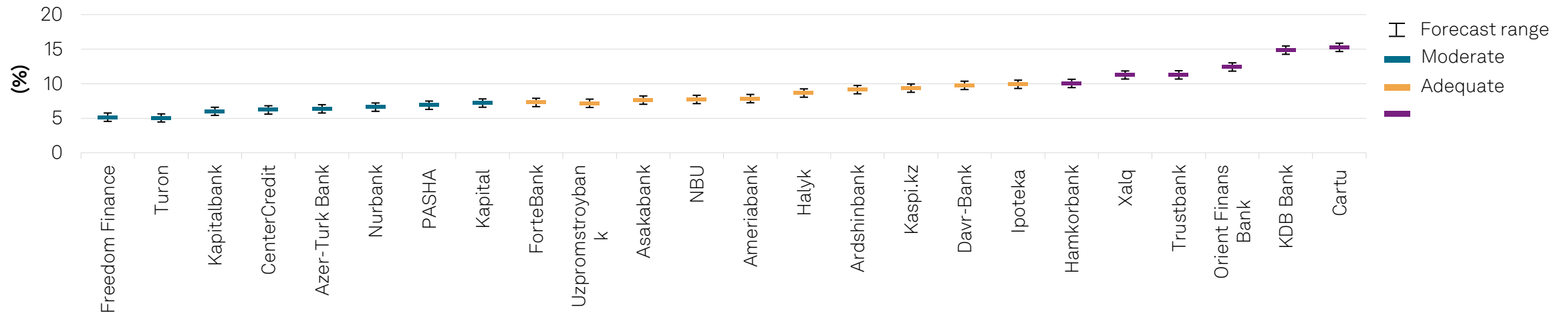
a--Actual, e--Estimate, f--Forecast. Source: S&P Global Ratings.

Capitalization Will Largely Remain Stable

- Larger and more established players are better positioned to continue 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 is largely comprised of tier 1 capital because the use of hybrid capital instruments is limited. On average, we expect regional banks will have moderate to adequate capitalization.
- Capitalization reported under local regulatory requirements exceeds our risk-adjusted capital (RAC) assessments due to differences in the calculation of asset risk weights and the treatment of tier 2 capital.

We expect RAC ratios in 2024 will largely remain stable, compared with 2022 levels

RAC ratios: Actual at year-end 2022 and forecast for year-end 2024



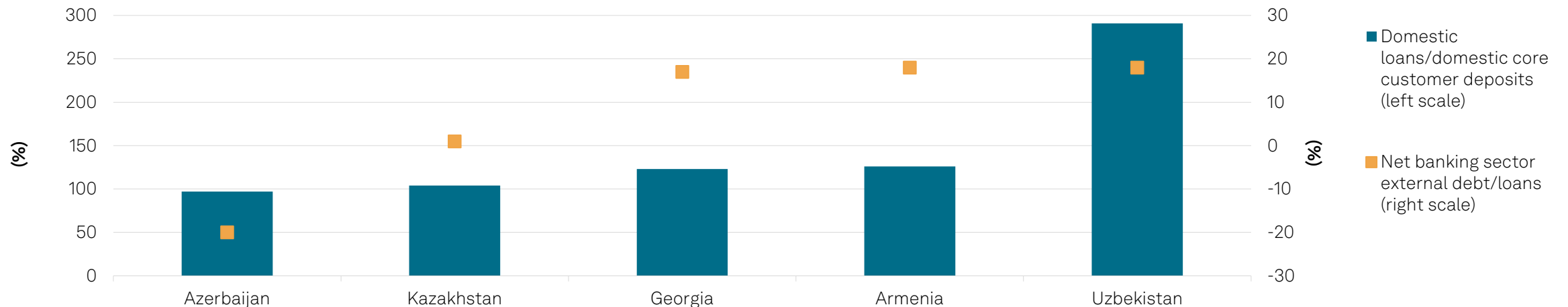
The legend shows the respective capital and earnings assessment of banks, as per our FI criteria. RAC--Risk-adjusted capital. Source: S&P Global Ratings.

Stable Deposit Base Benefits Funding

- Domestic deposits, government funding, and funding from international financial institutions will continue to be the main funding sources for banking sectors in the region and will benefit from the positive macroeconomic momentum.
- In our view, non-resident deposits are not a risk for funding because we expect they will likely remain stable, with an average share in total funding of about 10% across the region.
- The issuance of eurobonds will likely be immaterial as external funding remains expensive for emerging markets banks.

Banks' funding metrics

Data estimate as of year-end 2023



Source: S&P Global Ratings.

Evolving Regulation And Less Predictable Decision-Making

- In our view, Georgia and, to a lesser extent, Armenia demonstrate stronger regulation and supervision than regional peers.
- We consider banking regulation and supervision in Azerbaijan, Kazakhstan, and Uzbekistan fall short of developed market standards. Regulators' actions sometimes lacked clarity and predictability and were not timely enough to prevent aggressive risk-taking by banks in the past. While banking regulation and supervision in the region has improved gradually, it will take time to implement best practices and improve banking supervision to a level that is more in line with developed markets.
- The long history of unresolved problem loans and the eventual non-compliance with regulatory capital adequacy requirements led to license revocations of Muganbank in Azerbaijan in 2023, as well as Turkiston Bank and Hi-Tech Bank in Uzbekistan in 2022. This suggests some gaps in supervision and a lack of predictability and transparency.
- Over 2023, regulators in the region took various steps to limit risks in the banking sector, including annual systemwide asset quality reviews in Kazakhstan, improvements in corporate governance standards and disclosure in Azerbaijan, and gradually tightening lending requirements in response to the rapid increase in retail loans, particularly car loans, in Uzbekistan.

Armenia: Mortgage Lending Dwindles

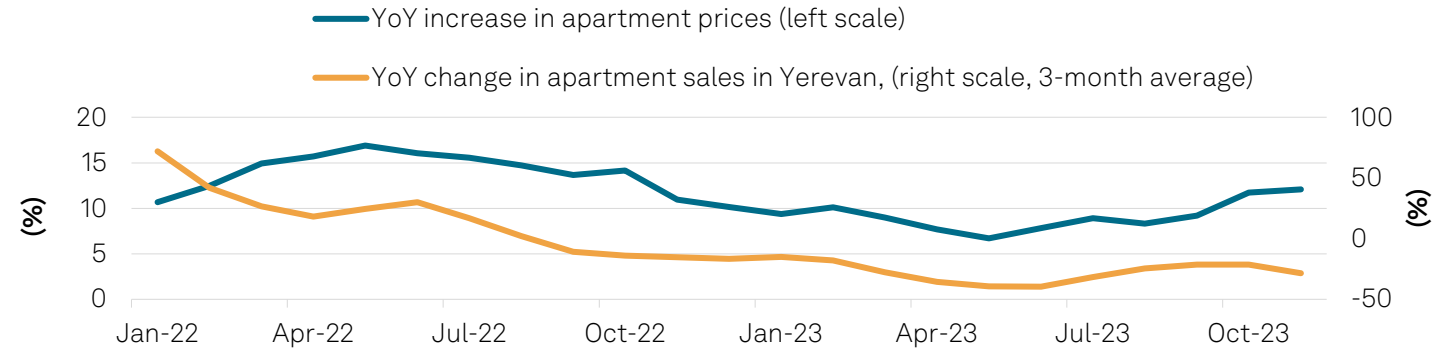
Credit drivers:

- Banks delivered a strong performance over 2022-2023, which enabled them to build capital buffers and withstand asset quality deterioration.
- Mortgage growth was still strong at 23% year-on-year in 2023. It benefited from tax credits, which subdued the dollarization of loan portfolios but fueled real estate prices and construction finance.

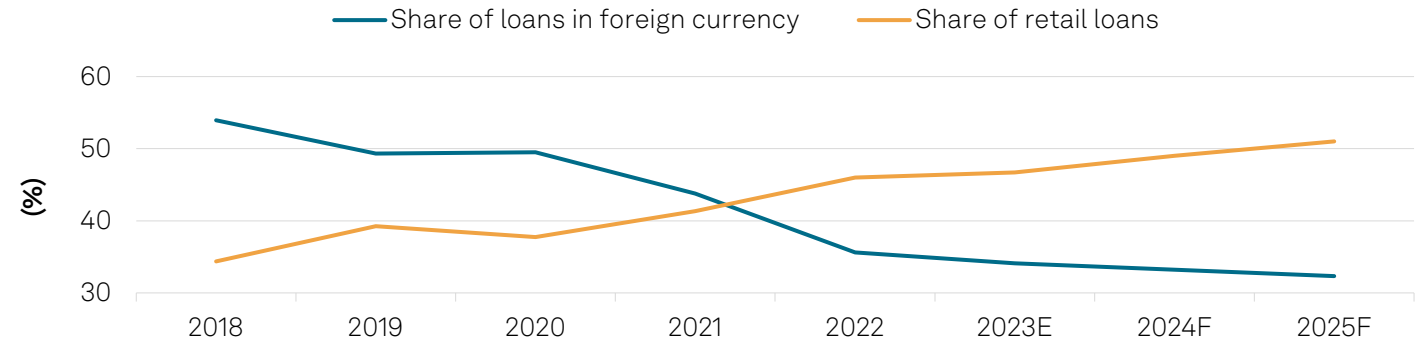
Expectations:

- The phase-out of mortgage tax credits will likely result in reduced mortgage lending from 2025, while looser monetary policies in the region could slow corporate foreign-currency credit growth. As a result, dollarization levels will remain subdued.

Apartment prices in Armenia's capital Yerevan spiked in H2 2023, despite lower sales



The share of foreign-currency loans will likely remain stable as retail credits increase



a--Actual. e--Estimate. f--Forecast. H2--Second half. YOY--Year on year. Source: S&P Global Ratings.

Azerbaijan: Lower GDP Growth Than Regional Peers

Credit drivers:

- The domination of state-owned banks and banks controlled by the ruling elite distorts competition. The region's top three banks--International Bank of Azerbaijan, PASHA Bank and Kapital Bank--accounted for 65% of assets, 70% of deposits, and 48% of loans as of year-end 2022.
- We believe these three banks will maintain better positions on capital market than other banks.

Expectations:

- Azerbaijan, which closed its land borders to foreigners in 2020 and has not opened them since, will continue to benefit less from immigration, remittances, and non-resident deposits than its regional peers.
- A long-term gradual decline in oil outputs will constrain Azerbaijan's medium-term growth prospects.

Georgia: Regulation Amendments To Monitor

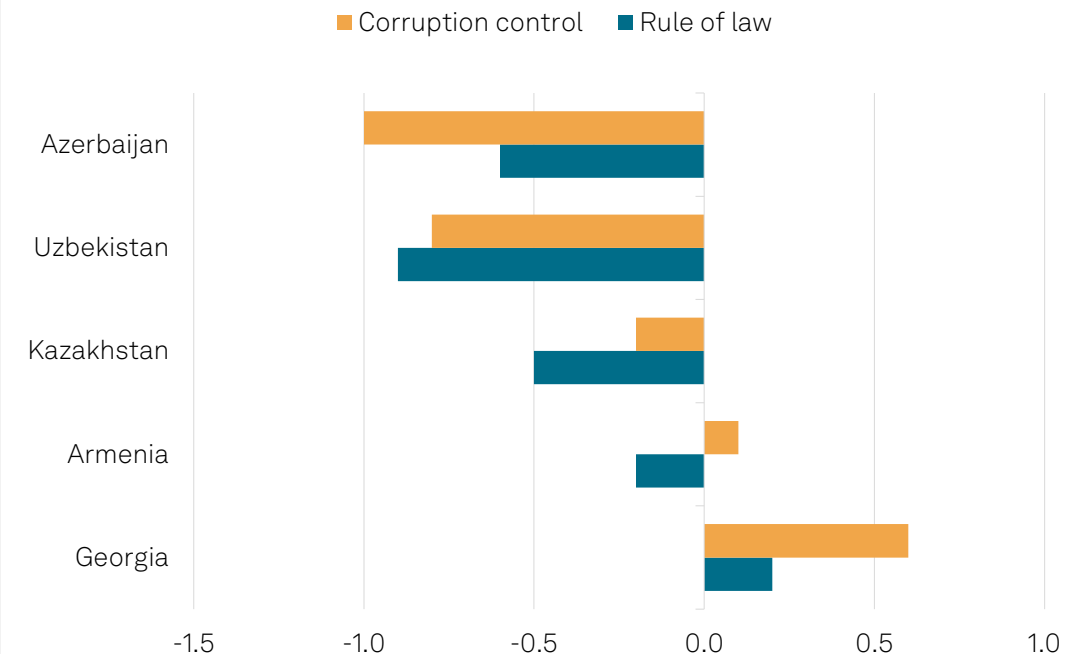
Credit drivers:

- We consider Georgia's institutional framework is stronger than peers', supported by better governance and transparency. Yet, recent regulation amendments could put the National Bank of Georgia's (NBG's) independence at risk.
- In June 2023, the NBG board introduced the role of the first vice-president, who is supposed to assume the duties of the NBG governor if the position becomes vacant and holds significant authority over monetary policy decisions. This might be seen as an excessive concentration of power.
- In September 2023, the NBG decided that a court order is required before banks can apply sanctions against Georgian citizens, resulting in the resignation of three board members, who questioned the credibility of the regulator's approach to the implementation of sanctions.

Expectations:

- We expect all Georgian banks will comply with international sanctions.
- We also expect credit growth will slow to 10%-12% in 2024, driven by regulatory measures that will limit retail lending in foreign currencies.

Georgia's institutional framework indicators exceed regional peers'



Sources: S&P Global Ratings, World Bank, 2022.

Kazakhstan: Lending Growth Under Control For Now

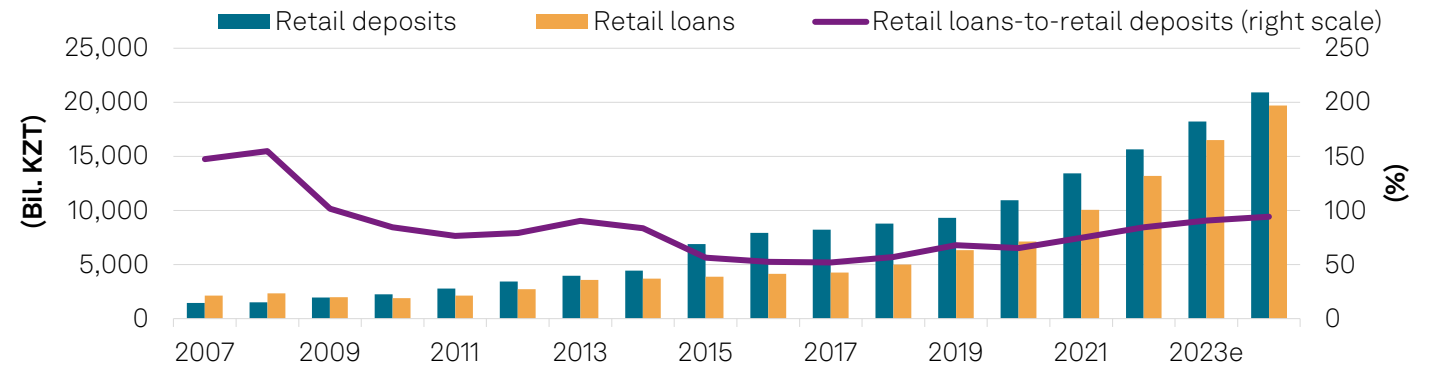
Credit drivers:

- A decrease in government support will curb mortgage origination over the next two years.
- The growth of customer deposits was not sufficient to support the rapid growth of banks' retail loan books. As a result, Kazakh households will likely have higher liabilities than assets.

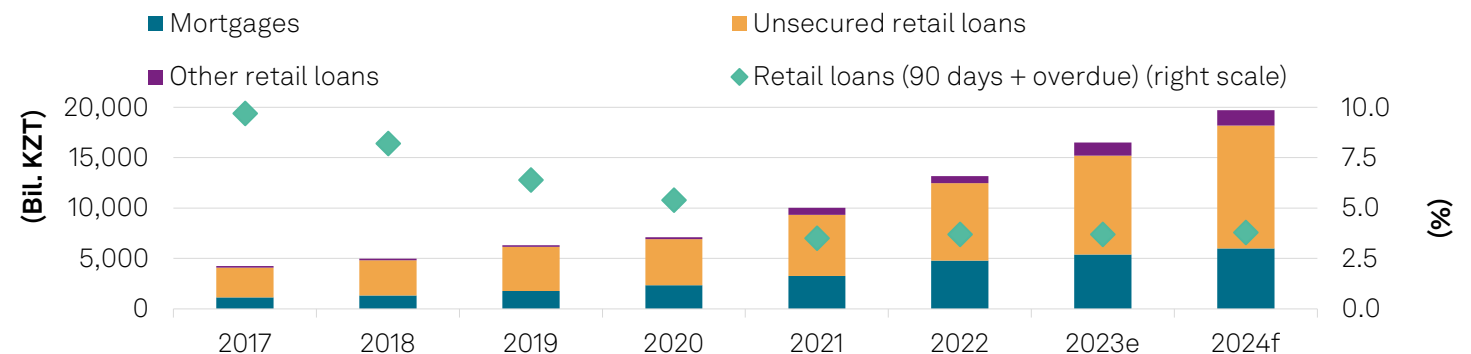
Expectations:

- We consider banks' credit risk is under control for now as growth in mortgages and unsecured consumer loans will likely moderate in 2024.
- In our base-case scenario, we forecast credit costs will remain subdued in 2024, at 1.3%-1.5% of average loan books.

Households could become net borrowers over next three years



Strong growth in retail lending will likely moderate in 2024



a--Actual, e--Estimate, f--Forecast. KZT--Kazakhstani tenge. Sources: S&P Global Ratings, National Bank of Kazakhstan.

Uzbekistan: Increasing Consumption Drives Retail Lending Growth

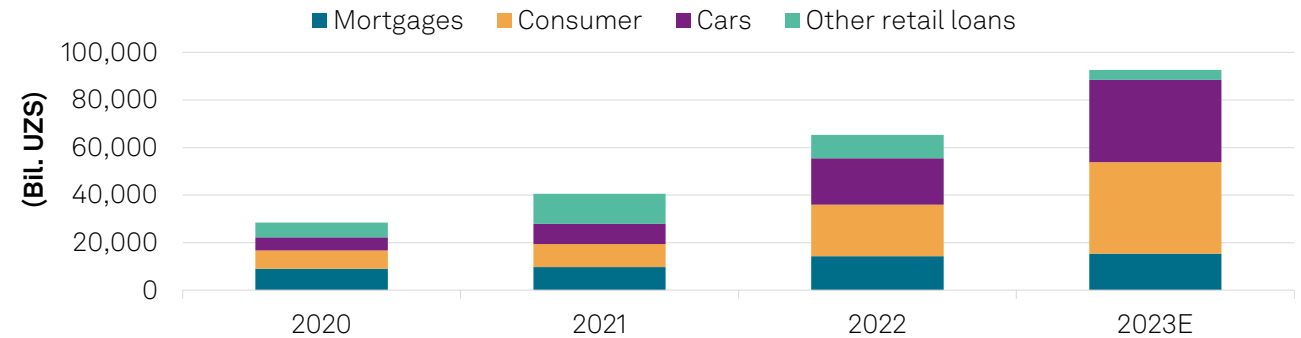
Credit drivers:

- The supportive macroeconomic environment and the gradual expansion of the private sector will support corporate lending growth, especially in the SME segment.
- The growing population and gradually improving disposable income drives consumer demand and strong retail lending growth in mortgages, car loans, and unsecured consumer loans.
- Uzbekistan's GDP per capita is among the lowest in the region and will limit the pace of credit growth.

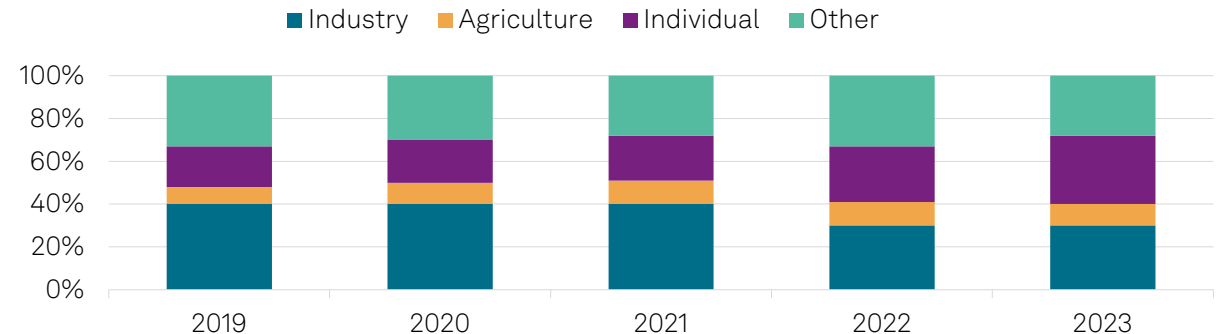
Expectations:

- Private and state-owned banks will further explore growth in retail and SME segments.
- Competition in the banking sector will intensify. Banks that invest more in automation and digitalization will be better positioned to meet client demands.
- The regulator will likely further tighten retail lending requirements, which will limit retail lending growth.

Newly issued retail loans drive lending growth



The share of retail loans is increasing significantly



a--Actual. e--Estimate. UZS--Uzbekistani sum. Sources: S&P Global Ratings, Central Bank of the Republic of Uzbekistan.

Banking Industry Country Risk Assessments (BICRAs)

- Predominantly stable economic and industry risk trends for all countries across the region.
- Positive economic risk trend in Armenia since the de-dollarization reduced credit risk.
- In 2023, we revised BICRAs for Azerbaijan and Kazakhstan to group 8 from group 9, indicating the improvement in overall risk levels for banking sectors in the region.

BICRA assessments

Country	BICRA group	Economic risk trend	Industry risk trend	Economic risk			Industry risk		
				Economic resilience	Economic imbalances	Credit risk in the economy	Institutional framework	Competitive dynamics	System-wide funding
Georgia	7	Stable	Stable	H	I	VH	I	H	VH
Uzbekistan	8	Stable	Stable	VH	I	VH	EH	H	VH
Armenia	8	Positive	Stable	H	I	EH	VH	H	VH
Azerbaijan	8	Stable	Stable	VH	H	VH	EH	H	H
Kazakhstan	8	Stable	Stable	H	H	EH	EH	H	H
Positive economic or industry risk trend		Stable economic or industry risk trend		Negative economic 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.

Rating Actions In 2023

Upgrades

Ameriabank (Armenia)	Improved sovereign rating
PASHA Bank (Azerbaijan)	Improved Azerbaijan BICRA
CenterCredit Bank (Kazakhstan)	Improved Kazakhstan BICRA
Bank Freedom Finance (Kazakhstan)	Strengthened group profile
Hamkorkbank (Uzbekistan)	Strengthened capitalization
Kapitalbank (Uzbekistan)	Strengthened business position

Outlook changes to positive

Ardshinbank (Armenia)	On improved risk profile
Kapital Bank (Azerbaijan)	On outperformance of peers
Cartu Bank (Georgia)	On reduction of legacy nonperforming loans
Fortebank (Kazakhstan)	On a change in sovereign outlook

Downgrades and negative outlook

Xalq Bank (Uzbekistan)	On slow progress of recovery of legacy problem loans
Freedom Finance (Kazakhstan)	Negative outlook on pressure on group's capital and risk position

Default

Muganbank (Azerbaijan)	Licence withdrawn on capitalization below the minimum and the bank failed to operate in a reliable and prudent manner
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Banks' Ratings And Rating Component Scores

Institution	Operating company long-term ICR/outlook	Anchor	Business position	Capital and earnings	Risk position	Funding and liquidity	CRA	SACP/ GCP	Type of support	Number of support notches	Additional factors
Armenia											
Ameriabank CJSC	BB-/Stable	bb-	Adequate	Adequate	Adequate	Adequate/Adequate	0	bb-	None	0	0
Ardshinbank CJSC	B+/Positive	bb-	Adequate	Adequate	Moderate (-1)	Adequate/Adequate	0	b+	None	0	0
Azerbaijan											
Kapital Bank OJSC	BB-/Positive	bb-	Adequate	Adequate (+1)	Adequate	Adequate/Adequate	0	bb-	None	0	0
Azer-Turk Bank	B+/Stable	bb-	Moderate (-1)	Moderate (0)	Adequate (0)	Adequate/Adequate	-1	b	GRE	1	0
PASHA Bank OJSC	BB-/Stable	bb-	Adequate	Moderate (0)	Adequate	Adequate/Adequate	0	b+	None	0	0
Georgia											
Cartu Bank JSC	B/Positive	bb	Moderate (-1)	Strong (+1)	Constrained (-2)	Adequate/Adequate	-1	b	None	0	0
Kazakhstan											
Bank CenterCredit JSC	BB-/Stable	bb-	Adequate	Moderate (0)	Moderate (-1)	Adequate/Adequate	0	b	Sov	1	0
Bank Freedom Finance Kazakhstan JSC	B/Negative	bb-	Moderate (-1)	Moderate (0)	Moderate (-1)	Adequate/Adequate	0	b	Group	0	0
ForteBank JSC	BB-/Stable	bb-	Adequate	Adequate (+1)	Moderate (-1)	Adequate/Adequate	0	b+	Sov	1	0
Halyk Savings Bank of Kazakhstan	BB+/Stable	bb-	Strong (+1)	Adequate (+1)	Adequate	Strong/Strong (+1)	0	bb+	None	0	0
Kaspi Bank JSC	BB/Stable	bb-	Strong (+1)	Adequate (+1)	Moderate (-1)	Adequate/Adequate	0	bb-	Sov	1	0
Nurbank JSC	B-/Stable	bb-	Constrained (-2)	Moderate (0)	Moderate (-1)	Adequate/Adequate	0	b-	None	0	0
Uzbekistan											
Davr-Bank	B/Stable	b+	Constrained (-2)	Adequate (+1)	Adequate	Adequate/Adequate	0	b	None	0	0
Hamkorbank JSCB	BB-/stable	b+	Adequate	Strong (+2)	Moderate (-1)	Adequate/Adequate	0	b+	None	0	0
Ipoteka Bank JSCM	BB-/Stable	b+	Adequate	Adequate (+1)	Adequate	Adequate/Adequate	0	bb-	None	0	0
Asaka Bank JSCB	BB-/Stable	b+	Adequate	Adequate (+1)	Adequate	Adequate/Adequate	0	bb-	None	0	0
Xalq Bank	B/Negative	b+	Moderate (-1)	Moderate (0)	Constrained (-2)	Adequate/Adequate	0	b	GRE	1	0
Kapitalbank	B/Stable	b+	Adequate (0)	Moderate (0)	Moderate (-1)	Adequate/Adequate	0	b	None	0	0
KDB Bank Uzbekistan JSC	BB-/Stable	bb-	Moderate (-1)	Strong (+1)	Adequate	Adequate/Adequate	0	bb-	None	0	0
NBU	BB-/Stable	b+	Strong (+1)	Adequate (+1)	Adequate	Adequate/Adequate	0	bb	None	0	-1
Orient Finans Bank POJSCB	B+/Stable	b+	Moderate (-1)	Strong (+2)	Moderate (-1)	Adequate/Adequate		b+	None	0	0
Trustbank	B+/Stable	b+	Moderate (-1)	Strong (+2)	Moderate (-1)	Adequate/Adequate	0	b+	None	0	0
Turon Bank	B/Stable	b+	Moderate (-1)	Moderate (0)	Adequate	Adequate/Adequate	0	b	None	0	0
Uzpromstroybank	BB-/Stable	b+	Adequate	Adequate (+1)	Adequate	Adequate/Adequate	0	bb-	None	0	0

Source: S&P Global Ratings; data as of Feb. 15, 2024. In the "Type of support" column, "None" includes some banks where ratings uplift because of support factors may be possible but none is currently included. For example, this column includes some systemically important banks where systemic importance results in no rating uplift. §Holding company; the rating reflects that on the main operating company. ICR--Issuer credit rating. GRE--Government-related entity. SACP--Stand-alone credit profile. GCP--Group credit profile. CRA--Comparative ratings adjustment.

Related Research

- [Various Rating Actions Taken On Azerbaijani Financial Institutions On Strengthened Systemwide Funding](#), Dec. 20, 2023
- [Banking Industry Country Risk Assessment: Georgia](#), Nov. 22, 2023
- [Banking Industry Country Risk Assessment: Kazakhstan](#), June 23, 2023
- [Banking Industry Country Risk Assessment: Armenia](#), May 19, 2023
- [Banking Industry Country Risk Assessment: Uzbekistan](#), Feb. 3, 2023

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