

**INITIATION
OF
COVERAGE**

KAZAKHSTAN DEBT RESEARCH: EXTERNAL DEBT

KEY INDICATORS

GDP, USD billion (1998, est)	22.3
GDP, USD billion (1999, f)	22.1
Gross External Debt 1H98, % of GDP	24.7
Debt service, USD million (1998, est)	540.0
Sovereign Eurobonds, USD million	550.0

EXTERNAL DEBT

OCTOBER 1998



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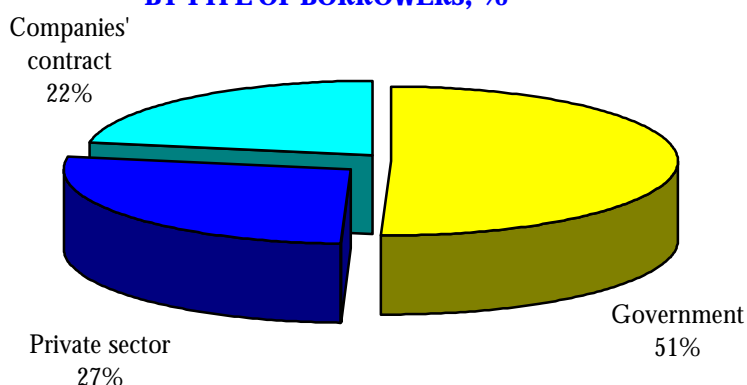
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GROSS EXTERNAL DEBT

Structure

Gross external debt is a sum of the external debt guaranteed by the Government and the debt of private companies without government guarantees. The Government's portion of the external debt is represented by direct credits from international financial institutions and the Governments of other countries, as well as by the two Eurobond issues.

**STRUCTURE OF THE EXTERNAL DEBT,
BY TYPE OF BORROWERS, %**

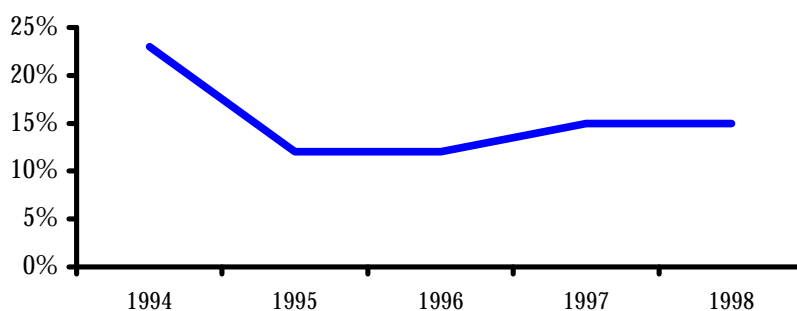


Source: National Bank of Kazakhstan

Dynamics

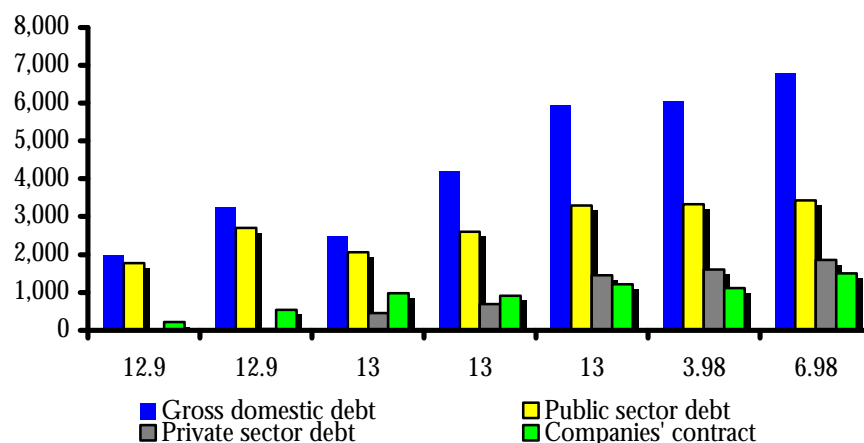
Kazakhstan's total external borrowing has increased significantly from USD 1.9 billion in early 1994 to USD 5.9 billion as of the beginning 1998. Within the gross external debt, there was a significant increase in the portion of debt which is not guaranteed by the Government, which is, in fact, the borrowing of second tier banks and private companies. These types of legal entities had not virtually existed before 1994 (or were not capable to borrow abroad), which explains the negligible amount borrowed by that type of borrower before 1995. Foreign trade contracts (mostly, import contracts), the payment on which is due, represent the portion of external debt which we call "companies' contracts", and it has increased dramatically since 1995.

EXTERNAL DEBT AS % OF GDP



Source: National Bank of Kazakhstan

EXTERNAL DEBT DYNAMICS, USD MILLION



Source: National Bank of Kazakhstan

Kazakhstan vis-à-vis other CIS countries

The table presented below shows the position of Kazakhstan's external debt compared with other CIS countries. Its ratio of external debt to GDP is modest; higher than in politically isolated, communist-oriented Belarus (9%), and much lower than in heavily burdened Turkmenistan (99%). Although in absolute terms the Kazak external debt is higher than those of other CIS countries, with the exception of Russia and Ukraine, it reflects the country's ability to attract foreign capital. It also shows that Kazakhstan did not have to focus so much on financing repayment of earlier debts (as Russia or Ukraine). Kazakhstan's external debt coverage ratio is realistic at 78% of exports, as opposed to 640% in Georgia or 147% for Russia. We also would like to stress that since the beginning of 1998, Kazakhstan has not taken steps towards increasing its external debt with just few exceptions of borrowing by second tier bank. On the other hand, Russia received multibillion dollar rescue packages from the IMF and other international financial organisations, and saw a series of eurobond issues by municipalities and corporations.

GROSS EXTERNAL DEBT OF THE CIS COUNTRIES, AS OF 1 JANUARY 1998

	USD bln	% of GDP	% of exports
Azerbaijan	1.5	38	191
Armenia	0.7	44	320
Belorussia	1.0	9	14
Georgia	1.6	32	640
Kyrgyzstan	1.1	63	190
Moldova	1.3	70	165
Turkmenistan	2.5	99	330
Uzbekistan	3.5	28	85
Ukraine	8.9	18	64
Russia	123.5	28	147
Kazakhstan	5.9	27	78

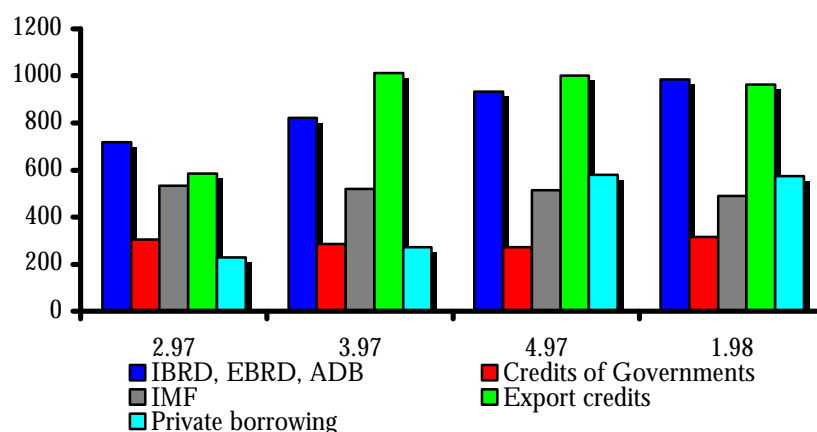
Sources: Intergovernmental CIS Committee

EXTERNAL DEBT: PUBLIC SECTOR

Structure

The public sector external debt includes direct government debt and the debt of other institutions which is guaranteed by the Government.

EXTERNAL DEBT OF THE GOVERNMENT IN 1997-98, BY TYPES OF LENDERS, USD MILLION



Source: National Bank of Kazakhstan

History

Kazakhstan had virtually no external debt immediately after it declared independence, and it has accumulated debt only since 1993. Therefore, unlike other countries with long external borrowing histories, the external debt burden remains modest. Moreover, the country's vast natural resources and active investment attraction programme allowed the Government to serve a portion of its financing needs without borrowing abroad. In addition, sovereign borrowing on international capital markets was restricted by the fact that the country itself and a few of its corporations just recently were awarded credit ratings by international rating agencies.

GOVERNMENT DEBT BY TYPE OF BORROWERS, USD MILLION

	1994	1995	1996	1997	1998 e
Government external debt	2,696.3	2,054.0	2,606.3	3,290.1	3,328.2
Government	1,600.1	597.4	1,119.3	1,742.9	1,845.0
National Bank	281.2	453.4	587.3	545.2	520.0
Companies	815	1,003.2	899.7	1002	963.2

Source: National Bank of Kazakhstan

MULTILATERAL FINANCIAL INSTITUTIONS

The World Bank

The World Bank loans represent 21.8% of the total state external debt. The vast majority of the loans are those of the International Bank for Reconstruction and Development (IBRD), and a relatively low share are from International Finance Corporation (IFC). We should mention that one of the largest IFC loans disbursed to date was the financing of restructuring at Ispat Karmet steel mill, in consortium with the European Bank for Reconstruction and Development (EBRD). All of the IBRD loans are long term and are aimed at restructuring industry, infrastructure, agriculture, the financial sector, and a social safety net. For the purposes of this paper, the repayment and/or servicing of the IBRD loans are just touched upon and are not analysed in detail due to their long term character.

IMF

The objective of IMF loans is to support the stability of the financial system through financing the balance of payment deficit and the supporting exchange rate stability. The IMF loans represent a minor portion of the state external debt (14.8%), and they are, like the other financing of international institutions, on a long term basis. Moreover, the IMF has approved a USD 480 million loan to Kazakhstan which has not been disbursed yet. However, the Government announced it is not going to take this money by the end of 1998 and/or afterwards, unless a serious threat to the stability of the national currency appears. So far, Kazakhstan can use this loan as an emergency kit, thus providing the National Bank and the Government with a room for manoeuvring.

Other international financial institutions

Other international financial institutions have a minor share in the government external debt. The European Bank for Reconstruction and Development (EBRD) and the Asian Development Bank (ADB) have participated in a number of projects which are crucial to the national economy, such as restructuring the Aktau Sea port, supporting the agriculture and financial sectors, environmental protection, and technical assistance. However, their share in the total government external debt is low, at 1.3% (EBRD) and 6.6% (ADB).

EBRD

The EBRD's only loan to the state sector is a USD 54 million credit facility provided for the reconstruction of the Aktau port on the Caspian Sea which was approved in March 1996. The objective of the loan is to modernise the port and upgrade its cargo-handling facilities. The development of the project has been successful so far, and now it is in the second stage of implementation which includes the reconstruction of the breakwater and strengthening the port's oil tanks/pipeline facilities.

Credits from foreign governments

Another important source of international borrowing for Kazakhstan has been the credits provided by the Governments of Germany, Japan, USA, Austria, and others. These credits played a crucial role in the national economy, especially those credits provided in the early years of independence. The amount of credits (stock) of the Governments of other states was around USD 300 million in 1997, which made up 9.5% of the government's total external debt.

Technical assistance

According to international principles, the funds under technical assistance programmes are not included in the external debt. However, the inflow

of funds under these programmes are quite significant and worth mentioning. According to the National Statistics Committee, Kazakhstan annually receives about USD 60 – 80 million of technical assistance from the Governments of USA, Japan, UK, Germany, and France, along with the European Community, UN, ADB and the World Bank. The objectives of technical assistance programmes are to strengthen the institutional development of Government and non-governmental organisations (NGOs), support privatisation programmes, and personnel training.

Export credits

The total volume of export credits under Government guarantees is about USD 1,900 million. The objective of such credits has been the financing of exports in the lender countries. Kazakhstan is currently repaying this debt stock, and the remaining principal amount due is USD 963.2 million, which is roughly 50% of all signed credit export agreements.

Recent developments

The most significant loan agreement in 1998 has been signed by the Government of Kazakhstan in September. Kazakhstan is to receive a USD 1 billion soft loan from the Japan (it is still unclear whether the loan would be from the Government of Japan or Japanese companies) with a maturity of 40 years and 10 years grace period. The interest rate for this loan would be between 0.75 and 2.20 per cent. This loan forms a part of the package offered to the Government of Kazakhstan in exchange for the sale of one seventh stake in the OKIOC oil and gas consortium to a Japanese and US companies. Other parts of the package include a USD 500 million cash bonus to the Government of Kazakhstan, which has been already received in full. The direct investment commitments are worth USD 2 billion and include a number of projects in oil and gas sector.

SOVEREIGN EUROBONDS

In October 1996 Kazakhstan tapped the international capital markets through the issuance of eurobonds. The debut tranche was just USD 200 million and it was well received by international investors. ABN AMRO Hoar Govett acted as a lead manager for this issue. The first tranche eurobonds are due in November 1999; they were placed at 9.25% annual coupon rate. These bonds were acquired by institutional investors from the US (40%), Europe (40%), and Asia (20%). After the Russian financial crisis the yields on these and other Kazak eurobonds have increased significantly.

Private lenders

The debt of the Government of Kazakhstan (and other debts of the private sector guaranteed by the Government) to private lenders was USD 573.5 million as of 1Q98. Of this amount, the majority of the Government's debt is associated with the holding of sovereign eurobonds.

Second issue

In the 3Q97 the Government of Kazakhstan and JP Morgan successfully completed the placement of the second tranche of sovereign eurobonds. The tranche was for USD 350 million and notes are due in 2002. The

annual coupon rate is about 8.3%.

EXTERNAL DEBT: PRIVATE SECTOR

Status

The growing importance of the private sector in the national economy is proved by the increasing foreign borrowing of private Kazak corporations. With an obvious lack of domestic capital its crucial that Kazak companies attract foreign capital. This type of external borrowing is made under guarantees arranged by the companies themselves and the Government does not accept any responsibility for such debt. The Government's advantage is that this debt is not included in the statistics of the Government external debt, while the capital imported by private entities is serving the national economy.

Historic trends

The peak of external borrowing by private Kazak corporations was observed in 1997 when it almost doubled as compared to 1996 and the total amount of borrowing exceeded USD 2,058 million. The total amount of external borrowing by private companies (without Government guarantees) during 1994-97 reached USD 3.7 billion. The share of non- guaranteed external borrowing by the private sector continues to growing, from 16.6% of the gross external debt in 1996 to 27.3% in 1Q98.

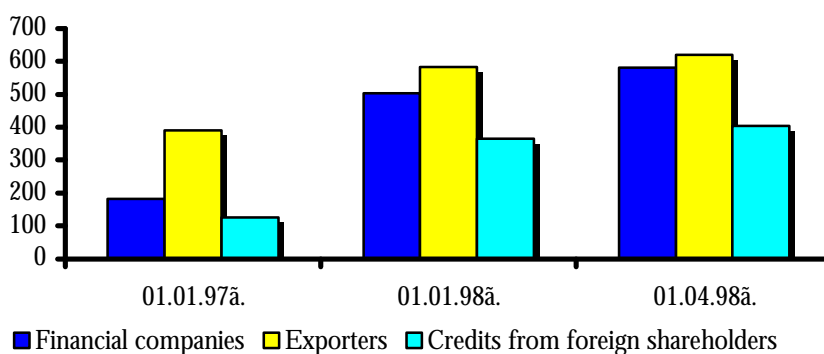
Maturities

The vast majority of the private sector loans are short term loans (USD 1,340 million in 1997). The share of short term loans in the total amount due in 1997 was 85%.

Companies vs banks

Of the non-guaranteed external debt, the major borrowers are companies and second tier banks. The share of companies reached 86.5% of the gross non guaranteed debt as of the beginning of 1998 and the stock of the debt was USD 1,390.4 million. The share of second tier banks increased dramatically from 0.5% (of the total non-guaranteed external debt) in 1996 to 9.0% in 1997 and 13.3% in the 1Q98. The stock of the external debt of second tier banks reached USD 213.6 million as of 1Q98.

**EXTERNAL DEBT OF THE PRIVATE SECTOR,
BY SOURCES, USD MILLION**



Sources: National Bank of Kazakhstan, National Statistics Committee

Breakdown of lenders

Foreign exporters make up a significant amount of credits to the private

sector (38.6% of total non-governmental external debt), while the contributions from foreign founders/shareholders in Kazakhstan-registered companies and branches make up another 25.2%. The external debt of second tier banks consists of 34.3% in total private sector external borrowing. This type of external borrowing is short term in most cases.

SYNDICATED LOANS

Industrial companies

In November 1997, the EBRD and IFC have signed a USD 450 million loan agreement with the international steel producer LNM Group, which owns the largest steel mill in Kazakhstan, Ispat Karmet. This loan was the first really long-term corporate borrowing for industrial purposes. The objective of the loan package is to meet the capital expenditure needs of one of Kazakhstan's largest companies. The syndicated loan announced in January 1998 is structured in the following way: there are three tranches of the loan (A, B, and D). The A loan is for USD 200 million, split between the EBRD and IFC (USD 135 million and 65 million respectively). This loan was structured as a 10-year amortising term loan with a 3-year grace period and this part of the financing facility was not syndicated. The B loan is a USD 200 million 6-year amortising term loan with a 3-year grace period. In this portion of the loan, the EBRD and IFC have equal contributions (USD 100 million each). This B loan was scheduled to be syndicated to banks with a USD 50 million 6-year revolving credit facility.

Samsung corporation, a German subsidiary of which owns and operates the largest non-ferrous producer in Kazakhstan – Kazakhmys Corporation, a copper integrated plant, obtained a syndicated loan facility arranged by Credit Lyonnais.

Kazkommertsbank: one of the largest corporate borrowers

Kazkommertsbank has been one of the largest corporate borrowers with its USD 100 million eurobond issuance and a number of syndicated loans arranged during the last few years. To this end, Kazkommertsbank is the key Kazak corporation in terms of attracting medium and long term foreign capital to finance the national economy.

Moreover, Kazkommertsbank serves as an agent of the Ministry of Finance in servicing credit lines provided by international financial institutions (Asian Development Bank, EBRD, etc).

Syndicated loans of Kazkommertsbank

The first syndicated loan for Kazkommertsbank was signed in July 1997, when the Bankers Trust arranged a medium-term syndicated loan worth USD 30 million. This loan was initially provided for six months and has been extended twice. Now it is due on 8 January 1999 and USD 10 million has already been repaid. The interest rate was initially fixed at the level of LIBOR+4% and in summer 1998 it was decreased to LIBOR+3.75%.

In November 1997, ING Barings and Commerzbank arranged a USD 50 million syndicated loan for Kazkommertsbank at a rate of LIBOR+3%. Another loan was arranged by the same banks in April 1998. This is a

USD 35 million loan for 1 year at LIBOR+3.75%.

In February 1997, the International Finance Corporation (IFC) approved two loans for Kazkommertsbank. Loan A is for 7 years and is worth USD 10 million, at a rate of LIBOR+4%. This loan represents a quasi-equity investment with an option given for IFC to buy shares in Kazkommertsbank. The Loan B approved is for up to USD 20 million and has to be syndicated by the IFC. This loan is in the pipeline and has not been disbursed yet.

Halyk Savings Bank (HSBK)

HSBK has been an active participant on the syndicated loan market since December 1997 when it received a syndicated loan. The loan initially was for USD 30 million, but because of high demand the amount was increased to USD 40 million. The objective of the loan was to finance trade, specifically to provide a pre-export facility. The term was for 3 months, LIBOR+ 250 bps, with an option of extending for three more months. This option was, in fact, exercised by the bank. This rate was the lowest ever rate obtained by a CIS company on an unsecured facility.

The syndicate was organised by American Express and co-arranged by Barclays bank (with their contributions of USD 5 million each) and includes CSFB, ING Barings bank, Bank Bruxelles Lambert, and London Forfaiting Asia, each contributing USD 3 million. Other participants' contributions accounted for USD 2 million (Rabobank, Bayerische Vereinsbank, Chase Manhattan Bank, and Skandinaviska Enskilda Banken) and USD 1 million (Bank Rozwoju Eksportu, Byblos Bank, DresdnerBank, and Vseobecna Uverova Banka).

The first convertible facility

The most recent syndicated loan received by Kazkommertsbank in July 1998 represents the first convertible facility in Kazak practice. Kazkommertsbank became the first Kazakhstani bank to obtain a direct loan from the EBRD. The USD 40 million loan is scheduled to be disbursed in two tranches. The terms of the first tranche include an option to buy shares in Kazkommertsbank, thus bringing the EBRD into the list of Kazkommertsbank's shareholders.

CORPORATE EUROBONDS

Kazkommertsbank

Kazkommertsbank issued its debut eurobonds in May 1998. This USD 100 million eurobond issue with a maturity of 3 years is due on 8th of May 2001, with a 11.25% coupon paid annually. ING Barings acted as the lead manager, and the syndicate included ABN AMRO, Chase Manhattan, HSBC, Santander Investment, WestMerchant., Commerzbank, BT Alex Brown International, and Kazkommerts Securities. This debut issue of eurobonds was well received by the investor community and it was oversubscribed. The eurobonds are traded at the Luxembourg Exchange and are cleared through the Euroclear system.

Outlook

To date, two more Kazak corporations have outlined their intentions to issue eurobonds: HSBK and a national electricity grid operator KEGOC. While HSBK had completed almost all of the procedures for issuing

eurobond and stopped at the road-show stage, KEGOC was at an earlier stage when the Russian crisis began. As a result of Russian financial turmoil, both companies decided to postpone eurobond issues until the market situation improves. In the meantime, some other Kazak corporations are searching for opportunities to raise capital in the international capital markets. The most probable candidates include the national oil company Kazakoil, the oil pipeline operator Kazaktransoil, the national telecommunications company Kazakhtelecom, and a few others. However, all these plans were put “on hold” because of the unfavourable situation for borrowers from emerging markets on the international eurobond marketplace. If the situation changes, we estimate the potential level of new eurobond issues to be between USD 500 -800 million. Of those, roughly USD 300 million may be borrowed by Kazakstani banks.

DEBT SERVICE

Trends

The peak years in debt servicing are 1998 and 1999. The National Bank of Kazakhstan estimates showing a USD 540 million debt servicing and repayment schedule for 1998 with respect to the external debt guaranteed by the Government. This is a two-fold increase as compared to 1997 and makes up 2.4% of the GDP. The forecasts for 1999 include the repayment of the principal amount on a USD 200 million eurobond issue and on a number of other loans provided by international institutions, which total USD 740.9 million (3.3% of GDP 1999 f).

Outlook

The Government has postponed its third issue of eurobonds (USD 350 - 500 million) planned for 1998 due to the deteriorating borrowing conditions on international capital markets. However, the small share of debt service obligations vis-à-vis GDP supports the Government’s cautious policy on avoiding foreign borrowing at high costs.

DEBT SERVICING FORECASTS, BY TYPES OF BORROWERS, USD MILLION

	1996	1997	1998 e	1999 f	2000 f	2001 f
Government external debt	347.9	335.5	539.7	740.9	447.8	399.4
Non-government external debt	764.5	1538.7	1,458.6	1,235.1	1,200.0	1,200.0
Total	1,112.4	1,894.2	1,886.3	1,976.0	1,647.5	1,599.4

Source: National Bank of Kazakhstan

OUTLOOK

External pressures

Kazakhstan, being a country which is heavily dependent upon export revenues for servicing its external debt, may face significant challenges

during the course of the next year. Weak commodity prices on world markets and deteriorating terms of trade on major commodities groups may lead to shrinking export revenues which are still crucial to the budget. The most recent data released by the Government on 19th of October 1998, shows a forecasted GDP decline in 1999. The 1999 GDP may reach USD 22.1 billion as opposed to estimates for 1998 at USD 22.3 billion (-1% GDP decline).

Domestic policies

The Government forecasts for 1999 show an increase in budget revenues as compared to 1998 (21.2% of GDP in 1999 vs 19.7% in 1998). The improved tax administration and a more cautious budget policy should help the Government to manage external debt and arrange all interest and principal payments on time.

Impact on the national economy

Having carefully studied all the publicly available materials of the National Bank and the Government, we do not doubt the ability of the Government to repay all the debts (including principal amounts and interests due) in 1998 and onwards. We also believe the major corporate borrowers including two major banks are capable of repaying their debts.

However, increased costs of borrowing and diminished new borrowing in 1998 and 1999 may lead to shrinking borrowing to the economy by the second tier banks. This point becomes especially important in Kazakhstan where there is a chronic lack of capital available to finance future growth. We expect a shrinking amount of credit will be given to the real sector of the economy by commercial banks and, therefore, credit requirements will tighten.

On the Government's side, we expect to see a tightening of the budget and of external debt policies. However, the Government may find other ways of financing future growth for the country through the accelerated privatisation of state-owned assets and the attraction of direct capital.

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