

Rating-Agentur Expert RA GmbH confirmed at 'B-' the FC rating and at 'B' the NC rating of Belarus. The rating outlook is positive.

Rating-Agentur Expert RA GmbH confirmed the sovereign government credit rating (SGC) of Belarus at 'B' (Moderately low level of creditworthiness of the government) in national currency and at 'B-' (Moderately low level of creditworthiness of the government) in foreign currency. The rating outlook is positive which means that in the mid-term perspective there is a high probability of upgrading the rating score.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- The economic growth in Belarus is expected to be around 3,4% in 2018, which is 1p.p. higher than a year ago. Such a positive trend was mostly due to an improved external environment and increased domestic demand. However, 3Q 2018 results showed a slower growth at 2,3% y-o-y as compared to 3,9% y-o-y in 2Q 2018, and we expect this trend to persist in 1H 2019. We still consider long-term growth to remain in the range of 2%-2,5% in the following years bound by the structural imbalances in the national economy as well as volatility of the Russian economy;
- The structure of the government debt in terms of maturity and creditors remains a credit strength. The short-term external debt is estimated at 6% of GDP and 15% of budget revenues by end-2018. Additionally, despite the recently intensified political discrepancies with the Russian government, which is the largest creditor of the country¹, we still consider the probability of the debt restructuring or prolongation as high. Moreover, the government's plans to diversify the debt structure by issuing RUB-denominated bonds on MOEX in 1Q 2019 as well as to issue CNY-denominated bonds on the Chinese market, support the rating assessment;
- The fiscal balance according to the IMF definition² is expected to reach -1,5% of GDP by end-2018, due to expenditures (mostly salaries) rising faster than revenues. The 2019 deficit can be higher due to the negative effects from the tax maneuver in Russia, slower economic growth and potential expenses increase before presidential elections in 2020;
- Belarus shows moderately high levels of economic development as GDP per capita in PPP terms and HDI were USD 20,2 th and 0,74 in 2018 and 2017 respectively.

Restricting factors:

- Gross government debt is estimated to have reached 56% of GDP and 142% of budget revenues respectively by the end of 2018, which shows an increase by 2,5p.p. and 4,3p.p. from a year ago;
- The fiscal authorities of Belarus showed a track record of gradual reduction of budget deficit in 2014-2017, based on tax rate increases, reduction of capital expenditures and new budget rules, while it substantially reduced the scale of off-budget operations. However, the negative fiscal balance in 2018 estimated by the IMF can indicate that the government returned to an expansionary fiscal policy. In addition, the upcoming presidential election in 2020 increases the pressure on fiscal metrics due to potential higher than expected increase of salaries and provision of additional financial support to

¹ Taking into account debt to Russian state-owned banks and Russian led Eurasian Fund for Stabilization and Development.

² Includes spending on SOE recapitalization/debt forgiveness.

socially important enterprises;

- The monetary policy of the National Bank of the Republic of Belarus (NBRB) improved substantially over the last years, including the liberalization of the FX-regime, gradual implementation of inflation targeting, de-dollarization measures and increase of the NBRB's operational independence. After several cuts of the interest rate by the NBRB, it stayed unchanged at 10% since 27 June 2018 due to higher inflation expectations and RUB volatility in 2H 2018. Inflation in 2018 remained within the NBRB's target of 6%. However, despite improvements, the policy effectiveness remains subdued by persisting directed lending, subsidized loans to SOEs and moderately high dollarization;
- Moderate levels of institutional development shown by a corruption perception index of 44 in 2017 (68th place out of 180 countries) as well as rule of law and government effectiveness indexes of -0,82 and -0,35 respectively in 2017³.

Negative factors:

- Contingent liabilities remain high as the government accounts for more than 65% of the total assets of the banking system and it owns around 50% of the whole economy. Moreover, the share of banks' claims to SOEs represents 55% of total banks' claims to the corporate sector;
- The local stock market remains underdeveloped as market capitalization is expected to be around 2% of GDP in 2018. However, the government actions focused on improvement of the financial market infrastructure, such as opening new cryptocurrency exchange, can have a positive effect on this factor;
- Wide spread between the Belarusian 12Y USD-denominated government bond (with maturity in 2030) yield and 10Y U.S. treasuries at an average of 4,5p.p. by December 2018, reflecting the market's conservative perception of Belarus's debt repayment risks;
- The banking sector soundness remained weak despite having slightly improved. The level of NPLs reported by the NBRB reached 4,1% by the end of 3Q 2018⁴ partly due to bad loans "localization". However, this figure was not confirmed by international organizations; thus, we still assess this as negative. The level of banks' assets and private credit is expected to increase slightly to 70,1% and 42,5% of GDP by end 2018 due to the economic recovery. Moreover, the dominance of state owned banks (SOBs) and high concentrations creates long-term risks for the system. Despite this, capital adequacy and profitability levels (ROA) remained high at 18,2% and 2% as of 3Q 2018;
- After reaching a record low inflation rate level of 4,6% by the end of 2017, the metric increased to 5,6% by end-2018, showing the still high volatility in prices.

Stress factors:

- High dependence from the Russian government and Russian-led funds as creditors, Russia's high share in the country's external trade has a strong adverse effect on the country's creditworthiness (weak stress factor);
- Still high financial dollarization of the economy with the share of FX loans and liabilities equals to 51% and 67% of total corresponding portfolio respectively as of 3Q 2018. Despite the positive dynamic during 2016-2017, we expect this factor to remain in place along 2019 (moderately weak stress factor).

Currency risks:

- High level of FX-denominated government debt expected to be at 46% of GDP, 117% of budget revenues and more than 80% of total government debt as of end 2018;
- The BYN still remains a risky and volatile currency, despite the slight decrease in volatility

³ As compared to the global leaders for rule of law index (Finland – 2,0) and government effectiveness indexes (Singapore – 2,2).

⁴ Starting from 1 April 2019 NBRB changed the rules and definitions for the non-performing loans and assets in order to harmonize them with the internationally accepted principles.

in 2016-2017 due to changes in the exchange-rate regime and dynamic of RUB;

- Despite the positive dynamic over the last years, the amount of FX reserves remained low at USD 7,2 bn by end-2018 which covers 29% of the country's external debt and only 2,3 months of imports;
- Significant dependence on imported goods with imports to GDP expected to exceed 70% in 2018.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Improvement of the banking system metrics, including level of NPLs, confirmed by international financial organizations;
- Sustained and higher than expected recovery of the national economy;
- Mitigation of debt repayment risks by end-2019 due to support from the Russian government and Russian led financial institutions;
- Outstanding improvement of financial dollarization levels.

The following developments could lead to a downgrade:

- Sharp deterioration of the asset quality of Belarusian banks due to poor creditworthiness of the borrowers;
- Continued rise of public debt and deficit metrics due to materialization of government's contingent liabilities and additional public spending before presidential elections in 2020;
- Sharp increase of inflation due to external or internal shocks;
- Materialization of risks related to the politically motivated decisions of the largest creditors and their current financial position that can lead to a steep reduction of external financial support.

"Our confirmation of sovereign government credit ratings of Belarus at 'B' in national currency and at 'B-' in foreign currency reflects the ongoing economic recovery, improvement of the banking system metrics, acceptable fiscal deficit as well as positive structure of the government debt in terms of creditors and maturity. We kept the positive outlook on both ratings due to our expectations for economic growth and gradual resolution of the "bad loans" issue in the banking system.

The ratings remained restrained by moderately high overall debt levels and its currency structure, volatile inflation, persistent contingent liabilities of the government as well as underdeveloped financial markets. We kept the currency risks due to meager level of FX reserves and a still risky status of the local currency." – Clarified Vladimir Gorchakov, Rating Associate of Rating-Agentur Expert RA GmbH.

Responsible expert: Vladimir Gorchakov, Rating Associate of Rating-Agentur Expert RA

Reviewer: Hector Alvarez, Rating Associate of Rating-Agentur Expert RA

Research report on Belarus is available at:

https://raexpert.eu/reports/Research_report_Belarus_18.01.2019.pdf

Next scheduled rating publication: 12 July 2019. The full sovereign rating calendar can be found at <http://raexpert.eu/sovereign/#conf-tab-5>

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
20.07.2018	Scheduled revision of both types of ratings for the country	B	B-	Positive	Positive
26.01.2018	Scheduled revision of both types of ratings for the country	B	B-	NA	NA
28.07.2017	Scheduled revision of both types of ratings for the country	B	B-	NA	NA
03.02.2017	Scheduled revision of both types of ratings for the country	B	B-	NA	NA
05.08.2016	Scheduled revision of both types of ratings for the country	B	B-	NA	NA
04.03.2016	First assignment of both types of ratings	B	B-	NA	NA

Minute's summary

The rating committee for Belarus was held on 18 January 2019. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: Methodology for Assigning Sovereign Government Credit Ratings – Full Public Version (from May 2018) can be found under the following link: https://raexpert.eu/files/methodology/Methodology_Full_Sovereign_V3.pdf. Descriptions and definitions of all rating categories can be found under the following link: <http://raexpert.eu/sovereign.php> under the "Rating scale" section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

These ratings are unsolicited. The rated entity did not participate in the rating process.

Main sources of information: World Bank, International Monetary Fund, Belstat, National Bank of Republic of Belarus, Ministry of finance of Republic of Belarus, BCSE, Börse Frankfurt, Cbonds, CBR, Rosstat, World Federation of Exchanges.

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Regulatory use

SGC ratings can be used for regulatory purposes according to the ESMA definition.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

Risk warning

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Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.