

Rating-Agentur Expert RA confirmed at 'B-' the sovereign government rating and upgraded to 'CCC+' the credit climate rating of Belarus

Rating-Agentur Expert RA 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.

Rating-Agentur Expert RA GmbH upgraded the country credit environment rating (CCE) of Belarus from 'CCC+' (Low quality of credit environment of the country) to 'B-' (Moderately low quality of credit environment of the country) in national currency and from 'CCC' (Low quality of credit environment of the country) to 'CCC+' (Low quality of credit environment of the country) in foreign currency.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Following the better performance of the key trade partners and resolution of the dispute with Russia on oil/gas trade conditions, the country's GDP recovered in 2017 growing at a 2,4% rate after two years of recession. However, the long-term growth prospects are limited by the structural imbalances in the national economy as well as the uncertainty regarding Russia's economic growth in 2018;
- Reduced short-run risk exposure with short-term external debt as of 3Q 2017 standing at 6,2% of GDP and 16% of budget revenues. Additionally, the fact that the largest creditors are the Russian government and Russian banks, facilitates a potential restructuring or prolongation of the debt;
- The fiscal budget is expected to reach a surplus of 1,7% in 2017 due to economic recovery and normalization of the trade with Russia. We believe that the government will keep reporting surpluses following its track record of cost-containment measures;
- Belarus shows moderately high levels of economic development as GDP per capita in PPP terms and HDI were USD 18,6 th and 0,74 in 2017 and 2016 respectively combined with moderate levels of institutional development shown by CPI index (40 in 2016), rule of law and government effectiveness indexes (-0,8 and -0,5 respectively in 2016).

Restricting factors:

- Gross government debt is expected to have remained elevated in 2017 around 55% of GDP and 143% of budget revenues. The Agency does not expect a significant increase in the debt metrics along 2018 taking into account the current dynamics of the ratios as well as the balance between debt repayment and issuance. However, in the long run, the debt metrics could increase due to the high level of contingent liabilities of the government and high share of FX-denominated debt;
- The fiscal policy of the Belarusian government keeps improving, but the share of quasi-fiscal operations remains high. The Belarusian fiscal authorities confirmed their intentions to have a budget surplus within the following years by implementing certain policies (such as tax increases, capital expenditures cuts and new budget rules). At the same time, the big gap between the surplus of the state budget in Ministry of Finance of Republic of

Belarus (MFRB) definition¹, the general government deficit and the overall fiscal balance² in accordance with IMF estimates could still be showing a large scale of quasi-fiscal operations;

- The effectiveness of the monetary policy remains limited due to the high levels of dollarization and still widespread directed lending. The NBRB gradually lowered the policy interest rate to 11% as of 18 October 2017 while the government keeps providing directed lending to SOEs (despite the gradual reduction of the scale of these operations).

Negative factors:

- The banking sector stability deteriorated significantly with the level of NPLs jumping from 6,8% in 2015 to 12,8% in 2017 due to a prolonged recession in the economy, chronic inefficiency of SOEs as well as the reassessment of the quality of bank's assets led by the National Bank of Republic of Belarus (NBRB) in 2016. In addition, the volume of private credit to GDP was reduced from 49,8% to 45% in 2017 and the state owned banks still dominate the system. However, banks' profitability remained positive, as yearly ROA stood at around 1,9% and capital adequacy ratio stood high at around 18,9% as of end 3Q 2017;
- The government of Belarus has a significant amount of contingent liabilities, as roughly 50% of the economy belongs to the government. Additionally, 65% of the banking system in terms of assets is owned by the government and the share of claims to SOEs was equal to 55% of total banks' claims to the corporate sector;
- Underdeveloped stock market, with market capitalization of the listed companies at 3% of GDP in 2017 and high concentration of trades in the 10 largest issuers;
- Relatively high yield on the 9Y USD-denominated government bond at an average of 5,5% by January 2018, reflects the market's perception of Belarus's debt repayment risks;
- As a result of lower consumption, a tight fiscal policy and the slight appreciation of BYN within the 2016-2017 period, the inflation rate reached 4,6% by end of 2017 which represented historically minimum levels. However, taking into account the high volatility of this metric within the last five years, the Agency can expect higher figures by the end of 2018.

Stress factors:

- High dependence on the Russian government and Russia-led funds as creditors, as well as its share in Belarus' external trade combined with the uncertainty about Russia's economic growth within the next years (weak stress-factor);
- High level of dollarization of the economy with the share of FX loans and deposits equal to 52% and 69% of total corresponding portfolio respectively as of November 2017. Despite the positive dynamic during 2016-2017, we expect this factor to remain in place within 2018 (weak stress-factor).

Currency risks:

- High level of FX-government debt equal to 47% of GDP, 124% of budget revenues and more than 90% of total government debt as of end 3Q 2017;
- BYN still remains a risky and volatile currency, despite the slight decrease of volatility in 2016-2017 due to changes in the exchange-rate regime and dynamic of RUB;
- Despite the positive dynamic over the last year, the amount of FX reserves remains low at USD 7,3 bn by end 2017 which covers 29,4% of the country's external debt and it accounts

¹ State budget in the definition of the Ministry of finance of Republic of Belarus: Republican budget, local budgets, state extra-budgetary fund of social protection of Republic of Belarus, the state off-budget Universal Service Fund of the Ministry of Communications and Information, the state extra-budgetary fund of civil aviation and state extra-budgetary fund of the Department of Penitentiary.

² In accordance to the IMF definitions: general government budget – sum of republican, local and social protection fund budgets; overall fiscal balance – balance of general government budget with inclusion of off-balance sheet operations.

for only 2,3 months of imports;

- Significant dependence on imported goods with imports to GDP being higher than 60% in 2017;
- Despite the improvement over the last years, the net foreign assets of Belarus are expected to be negative as of the end 2017.

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Positive factors:

- Driven by low inflation the real interest rate significantly decreased over the last two years and reached the level of around 10% by the end of 3Q 2017;
- Low levels of private sector debt to GDP (around 67% as of end 2017).

Restricting factors:

- The spread between interest rates on loans and deposits remains high around 6,5 p.p. as of November 2017.

Negative factors:

- Limited amount of financial instruments on the financial market combined with poor performance of the bond index over the last three years.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Improvements in the fiscal and monetary policies by significantly reducing directed lending and other off-budget operations;
- Stabilization of levels of inflation and real interest rates within the following years;
- Further decline of financial dollarization levels.

The following developments could lead to a downgrade:

- Further deterioration of the asset quality of Belarusian banks due to poor creditworthiness of the borrowers;
- Increase of public debt metrics due to materialization of contingent liabilities of the government;
- Sharp increase of inflation due to the external or internal shocks;
- Materialization of risks related to the current financial position of the largest creditors that can lead to a steep reduction of external financial support;
- Politically motivated decisions of the largest creditors, which can lead to a sudden stop of external financing.

“The upgrade of the country credit environment (CCE) ratings of Belarus was driven by the positive dynamics of the real interest rate, the recovery of the national economy after two years of recession as well as the government’s newly introduced programs to support new businesses. However, the ratings remained restrained by the absence of structural reforms related to inefficient SOEs, wide spread directed lending and poor development of national financial markets.

On the other hand, the sovereign government credit (SGC) ratings remained unchanged due to the elevated debt metrics, risks of potential materialization of contingent liabilities, persistent banking sector risks and, despite positive dynamics, continued high levels of dollarization along with a vulnerable external position. However, the high debt levels are partially mitigated due to the new debt refinancing agreement with the Russian government and a positive debt structure.

In addition, the fiscal balance has been positive and we expect it to remain at a surplus in the mid-term perspective” – Clarified Vladimir Gorchakov, Rating Associate of Rating-Agentur Expert RA GmbH”.

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

Reviewer: Marko Denic, Rating Analyst of Rating-Agentur Expert RA GmbH

Research report on Belarus is available at:

https://raexpert.eu/reports/Research_report_Belarus_26.01.2018.pdf

Next scheduled rating publication: 20 July 2018. The full sovereign rating calendar can be found at <http://raexpert.eu/sovereign/#conf-tab-5>

For further information contact:

Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00
E-mail: info@raexpert.eu
www.raexpert.eu

RATING HISTORY:

Date	Review reason	SGC		CCE	
		National currency	Foreign currency	National currency	Foreign currency
28.07.2017	Scheduled revision of both types of ratings for the country	B	B-	CCC+	CCC
03.02.2017	Scheduled revision of both types of ratings for the country	B	B-	CCC+	CCC
05.08.2016	Scheduled revision of both types of ratings for the country	B	B-	CCC+	CCC
04.03.2016	First assignment of both types of ratings	B	B-	CCC+	CCC

Minute's summary

The rating committee for Belarus was held on 25 January 2018. 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 and Country Credit Environment Ratings – Short Public Version (from April 2017) can be found under the following link: http://raexpert.eu/files/methodology/Methodology_Short_Sovereign_v2.pdf. Descriptions and definitions of all rating categories can be found under the following link: <http://raexpert.eu/sovereign.ph> 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.

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

Only SGC ratings can be used for regulatory purposes according to the ESMA definition. CCE ratings are not considered as credit ratings within the framework of Regulation (EC) No 1060/2009.

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

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's press-release and research report.

This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

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.