Research Report on Belarus

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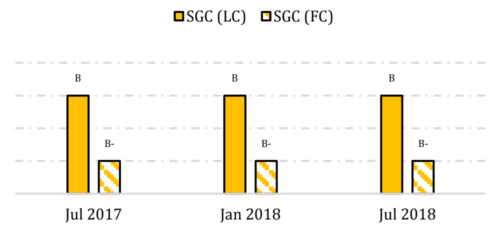
Ratings

Sovereign Government Credit (LC)	B
Sovereign Government Credit (FC)	B-
Outlook (LC)	Positive
Outlook (FC)	Positive

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Belarus

Macro indicators	2015	2016	2017
Gross gov. debt, BYN bn	47	50	53*
Nominal GDP, BYN bn	89	94	105*
Real GDP growth, %	-3,8	-2,5	2,4*
Gross gov. debt/GDP, %	53	53,5	50,9*
Deficit (surplus)/GDP, %	1,3	1,4	3,1
Inflation rate, %	11,9	10,5	4,6
Current Account Balance/GDP, %	-3,2	-3,5	-1,7*
External debt, USD bn	-	-	39,9

Development indicators	2016
Inequality adj. HDI	0,74
GDP per capita, USD th	18,04

Default indicator	20.07.2018
5-Year CDS spread, Bp	262,7
10Y Gov Bond Yield, %	6,7**

Source: RAEX (Europe) calculations based on data from the IMF, World Bank, MFRB, NBRB, Belstat, Cbonds.
* Forecast for 2017 ** Maturity in 2027

Summary

The Agency confirmed the ratings of Belarus based on solid economic growth, further improvement of fiscal stance and sustainable debt levels. Moreover, the debt structure in terms of type of creditors and maturity remains favorable; however, the FX share of the government obligations is substantially high. The positive outlook on both ratings is based on our expectations of a sustainable recovery of the national economy within the following years, as well as the expected mitigation of debt repayment risks by issuing long-term government bonds and restructuring of the liabilities to the Russian government and related fund.

Banking sector risks continue to affect the rating negatively due to the large share of state ownership and still widespread directed lending which might trigger a sharp increase of NPLs in the mid-term perspective. In the worst-case scenario, the debt metrics could increase in the mid run driven by the possible materialization of contingent liabilities. In addition, the ratings remain restrained by high levels of financial dollarization as well as by vulnerable external position of the country.

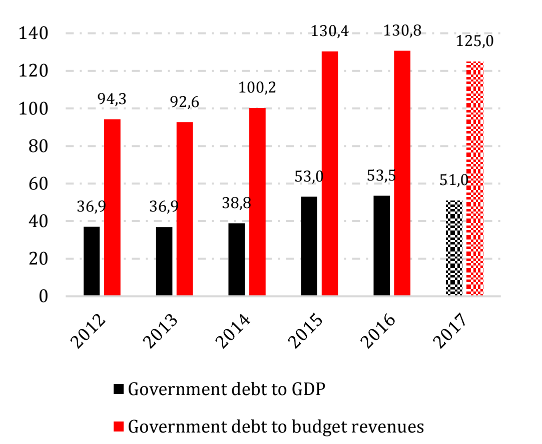
Government debt remains stable. According to the IMF, the gross government debt of Belarus is projected to have stood at around 51% of GDP and 125% of budget revenues as of the end of 2017 (see graph 1), which represents a slow downward trend of the debt metrics. The Agency expects this trend to remain in the upcoming years driving the debt level under 50% of GDP.

However, the amount of FX-denominated debt remains substantially high at 90% of overall debt and is equivalent to 47% of GDP and 114% of budget revenues. In addition, the ratio of international reserves to FX debt was as low as 29%, despite the positive dynamic over 2017.

Belarus obtained significant financial resources over 2017 and at the beginning of 2018 by issuing Eurobonds, receiving a loan from Russia and acquiring financing from the Eurasian Fund for Stabilization and Development. We believe that these funds should be sufficient to serve the debt obligation coming up in 2018.

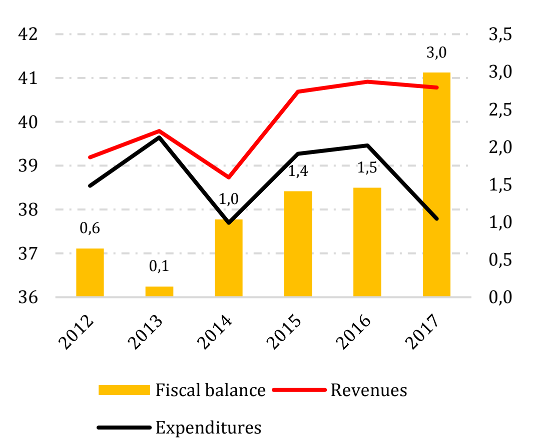
Moreover, we still see the potential materialization of contingent liabilities linked to the banking sector recapitalization as a risk that could cause a substantial increase in government obligations.

Graph 1: Government debt dynamics, %



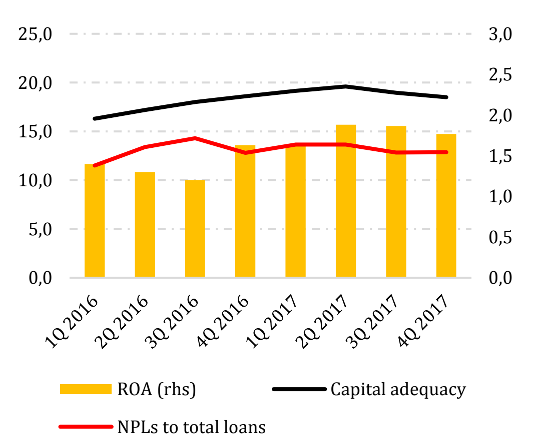
Source: RAEX (Europe) calculations based on data from the IMF and MFRB

Graph 2: Fiscal budget dynamics, % of GDP



Source: RAEX (Europe) calculations based on data from the IMF and MFRB

Graph 3: Financial soundness indicators, %



Source: RAEX (Europe) calculations based on data from the NBRB

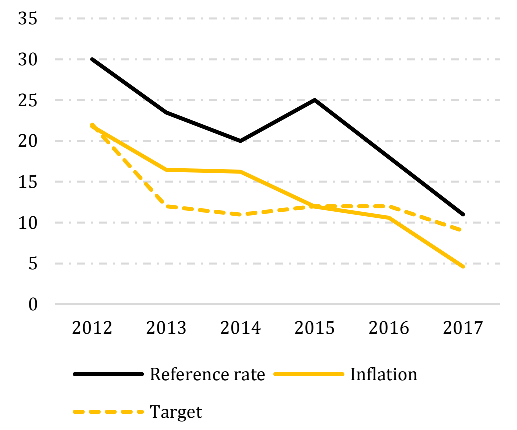
Fiscal stance is better than forecast. The fiscal trend over the previous year looked encouraging and as of end-2017 the fiscal balance according to the Ministry of Finance reached a surplus of around 3% of GDP mostly driven by solid economic growth and normalization of trade relationship with Russia (see graph 2). The authorities kept a tighter fiscal stance by restricting the expenditure through reduced directed lending and by curbing guarantees to state-owned enterprises (SOEs). However, risks of widening the fiscal deficit remain, as the government might return to a looser fiscal policy. Plans to subsidy different industries such as machinery and construction, as well as the construction of the new nuclear power plant could worsen the fiscal position.

In addition, the still wide gap remains between the fiscal balance net of quasi-fiscal expenditures and overall balance of general government in the IMF definition given the high amount of off-balance sheet operations from the government.

The banking sector remained fragile. Due to the still high volumes of directed lending and poor financial stance of SOEs, the Belarusian banking system remains exposed to the risk of sharp increase of NPLs in the mid-term perspective. As of the end of 2017, the level of NPLs to total loans stabilized at 12,9% (see graph 3), the volume of private credit to GDP declined down to at 41,9% and the state owned banks dominated in the system with around 65% of total assets belonging to the government. In order to reduce the risk of contingent liabilities arising from the banking sector, further restructuring of banks' bad assets and more control of the SOEs are required, since the most NPLs are linked to the losses of the SOE sector. Nonetheless, current banks' profitability remained positive, as yearly ROA stood around 1,8% and capitalization is solid with capital adequacy ratio at around 18,5% as of end-2017.

The central bank continued to lower the policy interest rate. After several cuts during 2017 and 2018, the policy interest rate was reduced to 10% as of 27 June 2018. The National Bank of the Republic of Belarus (NBRB) allowed for a more flexible exchange rate which stabilized further while inflation reached historically low level as of end-2017 and stood at around 4,6%, well below of the NBRB's target of 9% (see graph 4). This decline is mostly a result of a less volatile exchange rate and modest wage increase. We expect inflation to stay around 6% in the midterm due to higher wages, stronger domestic demand and changes of administratively regulated prices.

Graph 4: Base rate vs inflation rate, %



Source: RAEX (Europe) calculations based on data from the IMF and NBRB

However, the transmission mechanism of the monetary policy remains limited as a result of the still high levels of financial dollarization and continued directed lending at non-market-established rates.

External and macroeconomic position continued to improve. Economic recovery of the key trade partners such as Russia and some EU member states drove exports upwards. Furthermore, the floating currency regime impacted favorably the external stance of Belarus. Depreciation of the rubble resulted with more competitive Belarusian exports, followed by improved trade balance which as of end-2017 marked a deficit of 1,8% of GDP (compared to 3,5% over 2016-2015 period and 6,6% in 2014).

However, Belarus' external vulnerability risks remain present. The dependence on political and economic agreements with Russia, particularly the import price of oil and gas, as well as the debt structure, represents a risk which might cause a significant external shock to the overall economy.

The country's GDP recovered in 2017, growing by 2,4% after two years of recession based on abovementioned economic growth in key trade partners, as well as recovery of internal demand. However, we expect growth to remain around 2% in the following years bound by the structural imbalances in the national economy as well as macro performance of the Russian economy.

Important note for sovereign ratings

This Research Report shall be treated as a supplementary part of the published Press Release included in the following link:

https://raexpert.eu/reports/Press_release_Belarus_20.07.2018.pdf

Both documents shall be treated as essential parts of each other.

For further information on the factors, their weights, methodologies, risks and limitations of these ratings, and other regulatory disclosures, please refer to the Press Release and the website of the Agency.