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

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 upgraded it from 'B-' (moderately low level of creditworthiness of the government) to '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.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- The economy of Belarus has recovered after the recession, increasing real GDP growth to 3% in 2018 compared to 2,5% in 2017 mainly due to the expansion of household consumer activity, stimulated by rising real incomes, as well as increased consumer lending. In addition, there was growth in production and investment activity in all major economic sectors, except for agriculture, which showed a decline after a lean year. However, starting from 3Q 2018, the economy reached equilibrium, the effect of a low base was exhausted and a slowdown in the pace of growth of industries and consumer demand was observed. We expect that GDP growth in 2019 will not exceed 1,8% influenced by subdued economic growth in Russia and will also be held back as a result of structural problems in the national economy;
- Planned obligations to repay and service public debt amount to an average of BYN 7 bn per year during 2019-2021, at an acceptable level of 5,8% of GDP and 13,6% of budget revenues, with international reserves' coverage by 2,2x. That said, the government is paying considerable attention to negotiations on restructuring and prolongations of current debts with major creditors and expanding sources of borrowing to diversify and cheapen resources;
- According to the Ministry of Finance of the Republic of Belarus (MFRB) in 2018, the budget revenues were estimated at BYN 51,6 bn, whereas the main government expenditures were curtailed. This dynamic led to a surplus of 4% of GDP according to the national definition. However, the MFRB's estimates based on the IMF methodology, which includes also off-balance costs and costs of construction of the Belarussian NPP, shows a more narrow fiscal surplus of 0,2% of GDP in 2018. From 2019, in order to eliminate discrepancies, the MFRB methodology was aligned with the IMF, which we view as a positive signal to improve the quality of the authorities' fiscal policy. MFRB forecasts the decline of overall balance in 2019 to -3% of GDP. The realization of the Russian tax maneuver from 2019 can negatively influence the budget revenues in the absence of compensation from Russia, and from the expenditure side, in the Agency's view, the presidential election in 2020 can intensify government spending;
- Belarus shows moderately high levels of economic development as GDP per capita in PPP terms and level of investment in human capital were USD 20 th and 0,74 in 2018 and 2017 respectively.

Restricting factors:

- The gross government debt in 2018 has grown by 3,4% in absolute terms mainly due to depreciation of the BYN in 2H 2018 as the share of FX government debt is almost 90% of the total debt. As a result, the government's debt burden remained at a fairly high level of more than 45% of GDP and 110% of budget revenues as of the end of 2018 in the "extended" IMF definition, which includes government guaranteed debt. The government keeps steps towards gradual diversification of the sources of borrowings, which are traditionally Russia and China, by issuing Eurobonds worth USD 0,6 bn in 2018. In 2019 Belarus continues to be active on the capital markets, which is confirmed by current plans to issue RUB 30 bn worth of government bonds on the Russian market. Such activities are also connected to the fact that, till the end of 2019, the government faces short-term debt repayments of USD 3,3 bn in the absence of sufficient support from the budget and unclear amount of further bilateral support from Russia;

- Prudent monetary policy over the past few years shows its effectiveness in improving macroeconomic and price stability. After a consecutive reduction of the key rate during 2018 by 1p.p. to 10%, it was not changed, and we expect it to remain stable if annual inflation is in the target range of 5%. However, monetary policy efficiency is still limited by high dollarization of the economy and weak financial market, as well as low independence of the National Bank of the Republic of Belarus (NBRB);
- The level of the institutional development is supported by moderate quality of business environment: 37th position in the Doing Business ranking 2019 and the moderate corruption perception index - 44 (70th place out of 180 countries in 2018). However, the low government effectiveness and rule of law indexes of -0,82 and -0,35 respectively in 2017 reflect the lack of independence of the government from political pressure;
- The spread between the yield on Belarusian Eurobonds with remaining maturity of 11 years and the 10Y U.S. treasuries was 3,3p.p at the beginning of 2Q 2019. The decrease in the cost of borrowing fostered by the improvement of the country's sovereign credit ratings in 2018.

Negative factors:

- High risk of contingent liabilities' materialization, which emerges from the state ownership oversaturation in the economy, creates pressure on the public debt. Inefficient and noncompetitive SOEs concentrate around 50% of the whole economy and all workforce, state banks' share remains above 60% despite gradual decline and more than half of the loan's portfolios attributed to the SOEs. Currently, the government does not intend to privatize its main assets, except for some minor cases, such as plans to sell the part of Belinvestbank's shares to EBRD. Even though the deal will have a positive effect on the banking system investment attractiveness, this will not lead to a significant decline of the government contingent liabilities in the mid-term perspective;
- The stock market is characterized by low liquidity and trading volumes, as the total capitalization of companies operating on the national stock exchange does not exceed 6% of GDP with almost 99% concentration in ten companies. The main source of financing for companies remains bank loans, including subsidized lending. However, the authorities continue steps towards the development of the local financial infrastructure, including plans of joining IOSCO in the mid-term perspective[1]. In addition, the role of bonds in the economy has risen mainly due to the active issues in the private sector; as a result, the corporate bond market grew by 21% in 2018 and equaled the volume of government bond markets in terms of market value, although the corporate sector is almost two times lower in trades volume than the government one;
- The banking sector is still weak with assets around 59% of GDP and private sector lending no more than 41% of GDP in 2018. The high concentration of SOBs reached 60% of the sector's assets with potential contingent liabilities, which hinders effective development and competition. Capital adequacy ratio remained without significant changes at the level of 18,1%, efficiency was slightly improved with ROA reached 1,7% as of 1Q 2019 (1,4% in 2017). Despite a "technical" improvement of the NPLs figures at the beginning of 2018,

[1] International Organization of Securities Commissions.

caused by the implementation of a new methodology, a negative dynamic was observed with an increase in the bad loans share from 3,7% in the end of 2Q 2018 to 6% at the end of 1Q 2019 (with comparable methodology). We estimate that the real volume of distressed assets may be higher, since the share of SOEs, including plenty of unprofitable ones, in banks' loan portfolio reached 60%. In addition, asset quality may deteriorate in the event of a decrease of the efficiency of the export-oriented SOEs, especially if the progress is not reached in negotiations on the compensation for the consequences of Russia's tax maneuver;

- After a significant slowdown in 2017 to 4,6%, inflation accelerated due to domestic price factors to 5,7% as of June 2019. Even though it is close to the target range of the NBRB at 5%, the inflation remains volatile and inflationary risks remain high under pressure from agricultural products and fuel prices, with a sensitivity to inflation's dynamic in Russia.

Stress factors:

- The risks for the creditworthiness stem from the direct and indirect dependence on the relationships with Russia, as well as the economic and political situation of this major trading partner and creditor (weak stress-factor);
- Although the share of banks' FX-denominated assets and liabilities continues to decline, dollarization in Belarus remains one of the highest among the peers' countries of the region, at 47,1% and 59,4% for loans and funds of customers, respectively as of 1 April 2019. The current FX exposure significantly limits the effectiveness of monetary policy and increases the sensitivity of the economy to fluctuations in the exchange rate of the national currency (moderately weak stress-factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Mitigation of debt repayment risks by end-2019 due to support from the Russian government and Russian led financial institutions in form of new loans disbursement, debt restructuring and financial compensation for adverse effects from the Russian tax maneuver in oil industry;
- Improvement of the banking system metrics, including decrease of the level of NPLs, as well as increase of trust into the asset quality assessment disclosed by local banks;
- Outstanding and gradual improvement of financial dollarization levels.

The following developments could lead to a downgrade:

- 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;
- 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 deterioration of the asset quality of Belarusian banks due to poor creditworthiness of the borrowers and high share of FX-debt;
- Sharp increase of inflation due to external or internal shocks.

"The Agency upgraded the credit rating of the Republic of Belarus to 'B' in foreign currency and confirmed at 'B' in national currency with a positive outlook on both ratings. This improvement reflects the strengthening of the external position with growing international reserves, reduction of the exchange rate volatility and the completed liberalization of the foreign currency regime with no restrictions for FX-operations. Along with this, the rating remains supported by stable economic growth, lower government debt burden and improvement of the fiscal policy's quality.

However, the rating is restrained by high contingent liabilities of the government, hidden risks in the banking sector and the underdeveloped local financial market, which restricts the efficiency of the monetary policy.

We kept the positive outlook on both ratings reflecting the high probability of upgrading the ratings in the near future. We can raise the ratings in the case of a partial or full resolution of the uncertainty in regard to additional financial support from Russia together with the overall decrease of dollarization levels" – Clarified Vladimir Gorchakov, Rating Associate of Rating-Agentur Expert RA.

Research report on Belarus is available at:

https://raexpert.eu/reports/Research_report_Belarus_12.07.2019.pdf

Next scheduled rating publication: TBD in December 2019. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2019

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
18.01.2019	Scheduled revision of both types of ratings for the country	B	B-	Positive	Positive
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 12 July 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 April 2019). Descriptions and definitions of all rating categories can be found 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.

The definition of default can be found on the Agency's website in the section for Internal policies.

These ratings are unsolicited. The rated entity did not request the rating. The rated entity (i.e. the Ministry of Finance of the Republic of Belarus) participated in the rating process.

Main sources of information: World Bank, International Monetary Fund, Belstat, National Bank of the Republic of Belarus, Ministry of finance of the 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.

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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.