Rating-Agentur Expert RA GmbH confirmed at 'B-' the ratings 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 recovery of key trade partners such as Russia and some EU member states and the improvement of relations with Russia after the gas price dispute contributed to the recovery of the country's GDP in 2017 which grew by 2,4% after two years of recession. However, we expect growth to remain at around 2% in the following years bound by the structural imbalances in the national economy as well as macro performance of the Russian economy;
- Reduced short-run risk exposure with short-term external debt standing at 5,8% of GDP and 14,3% of budget revenues in 2017. Additionally, the fact that the largest creditors are the Russian government and banks, facilitates a potential re-structure or prolongation of the debt;
- The fiscal balance reported by the Ministry of Finance reached a surplus of 3% in 2017 due to the economic recovery over the year and normalization of the trade with Russia. However, the overall public balance could have lower surplus or even mark a deficit, since the figure reported by the ministry does not include quasi-fiscal operations. Though, the government shows willingness to maintain fiscal surpluses following its track record of tightening the fiscal policy, cutting down off-budget spending and direct lending;
- Belarus shows moderately high levels of economic development as GDP per capita in PPP terms and HDI were USD 18,9 th and 0,74 in 2017 and 2016 respectively.

Restricting factors:

- In 2017, gross government debt stood at around 51% of GDP and 125% of budget revenues respectively. Considering the tighter fiscal policy, sustainable balance between debt repayment and issuance, followed by favorable debt ratios dynamics, we do not expect a significant increase in the level of debt within 2018. However, the large share of FX-denominated debt and potential materialization of contingent liabilities could elevate the total debt level;
- Despite serious steps in the direction of tighter fiscal policy, the share of quasi-fiscal operations remains high, shown by the wide gap between the balance of the state budget in the Ministry of Finance of Republic of Belarus (MFRB) definition[1] and the overall fiscal balance[2] in accordance with IMF estimates. The Belarusian fiscal authorities confirmed their intentions to have a budget surplus within the following years by implementing

[1] State budget in the definition of the Ministry of finance if 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.

certain policies (such as increasing the tax rates, cutting of capital expenditures and introducing new budget rules); however, contingent liabilities, such as government intervention in state owned failing banks still represents a significant fiscal risk;

- The National Bank of the Republic of Belarus (NBRB) gradually lowered the policy interest rate down to 10% as of 27 June 2018 while the government keeps providing directed lending to SOEs (despite the gradual reduction of the scale of these operations). Moreover, the monetary policy transmission mechanism remains subdued due to the still widespread directed lending and high levels of dollarization. Nonetheless, dollarization levels have declined over the last years: since 2015 the share of deposits in national currency increased by more than 5p.p.;
- Moderate levels of institutional development shown by a corruption perception index of 44 in 2017 as well as rule of law and government effectiveness indexes of -0,8 and -0,5 respectively in 2016.

Negative factors:

- The banking sector remained fragile in 2017 with the level of NPLs to total loans at 12,8%, the volume of private credit to GDP at 42% and the state owned banks dominating in the system. In addition, 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, which is partly mitigated by the high level of capital adequacy ratio[3] at 18,5%. Nonetheless, banks' profitability remained positive, as yearly ROA stood around 1,8% and the as of end-2017;
- Contingent liabilities still represent a significant risk as the government accounts for 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;
- Underdeveloped stock market, with market capitalization of the listed companies lower than 3% of GDP in 2017 and high concentration of trades in the 10 largest issuers;
- Wide spread between the Belarusian 10Y USD-denominated government bond (with maturity in 2027) yield and 10Y bonds of US government at an average of 4,1 p.p. by July 2018, reflecting the market's perception of Belarus's debt repayment risks (5,5% as of January 2018);
- Despite the historically low level of inflation rate of 4,6% by the end of 2017, driven by lower consumption, tight fiscal policy and slight appreciation of BYN within 2016-2017 period, inflation in Belarus remains high and we can expect the rate to rebound up to 6% by the end of 2018 due to the wage increase, stronger internal demand and changes of administratively regulated prices.

Stress factors:

- High dependence on the Russian government and Russian-led funds as creditors, Russia's high share in the country's external trade combined with the uncertainty about its growth within the next years (weak stress-factor);
- Still high financial dollarization of the economy with the share of FX loans and deposits equal to 51% and 67% of total corresponding portfolio respectively as of end-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, 114% of budget revenues and more than 90% of total government debt as of end-2017;

[3] Regulatory Capital to Risk-Weighted Assets.

- The BYN still remains a risky and volatile currency, despite the slight decrease in 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 international reserves remains low at USD 7,3 bn by end 2017 which covers 29,3% of the country's external debt and only 2,2 months of imports;
- Significant dependence on imported goods with imports to GDP at more than 65% in 2017.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Sustained recovery of the national economy;
- Mitigation of debt repayment risks and continued decline of government debt levels;
- Outstanding improvement 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;
- Rise of public debt metrics in case of materialization of government's contingent liabilities;
- Sharp increase of inflation due to the 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.

"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." – 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_20.07.2018.pdf

Next scheduled rating publication: TBD in December 2018.

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		Outlook	
		National currency	**Foreign currency**	**National currency**	**Foreign currency**
26.01.2018	Scheduled revision of both types of ratings for the country	B	B-		
28.07.2017	Scheduled revision of both types of ratings for the country	B	B-		
03.02.2017	Scheduled revision of both types of ratings for the country	B	B-		
05.08.2016	Scheduled revision of both types of ratings for the country	B	B-		
04.03.2016	First assignment of both types of ratings	B	B-		

Minute's summary

The rating committee for Belarus was held on 19 July 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 – 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

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.