

Rating-Agentur Expert RA GmbH confirmed at 'B-' the sovereign government and at 'CCC' the credit climate ratings of Belarus.

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.

Rating-Agentur Expert RA GmbH confirmed the country credit environment rating (CCE) of Belarus at 'CCC+' (Low quality of credit environment of the country) in national currency and at 'CCC' (Low quality of credit environment of the country) in foreign currency.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Reduced exposure to short-run risks with short-term external debt as of 1Q 2017 at 6,4% of GDP and 16% of budget revenues. Additionally, the fact that the largest creditors are the Russian government and Russian banks, facilitates a potential re-structuring or prolongation of the debt;
- Despite weak economic activity, the fiscal budget posted a surplus of 1,4% in 2016. We expect the government to keep reporting surpluses following the newly introduced taxes, as well as 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 18,1 th and 0,74 in 2016 respectively combined with moderate levels of institutional development shown by a CPI index of 40 in 2016 and a rule of law index and government effectiveness index of -0,8 and -0,5 respectively in 2015.

Restricting factors:

- Revised figures show that gross government debt, despite growing over the last years, remained at acceptable levels in 2016 at around 52% of GDP and 130% of budget revenues. The Agency does not expect a further increase of the debt metrics by the end of 2017 taking into account current dynamics of the ratios. However, in the long-run, the debt metrics could increase considering the high level of contingent liabilities of the government and the share of FX-denominated debt;
- The quality of fiscal policy keeps improving, but the share of quasi-fiscal operations remains high. The Belarusian authorities confirmed their intentions to have a budget surplus within the following years by certain actions such as tax rates increase, cutting of capital expenditures and new budget rules. At the same time, the big gap between surplus of the state budget in Ministry of finance of Republic of Belarus (MFRB) definition¹, general government deficit and overall fiscal balance² in accordance with IMF estimates could be still showing large scale of quasi-fiscal operations;
- The effectiveness of monetary policy remains limited due to high levels of dollarization and still widespread directed lending. The National Bank of Republic of Belarus (NBRB) gradually lowered the policy interest rates to 12% as of 19 June 2017 while the

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.

government keeps providing directed lending to SOEs (despite the gradual reduction of the scale of these operations). In addition, monetary policy transmission mechanism remains distorted by high levels of dollarization despite the improvements of this indicator over the last year.

Negative factors:

- The banking sector stability deteriorated significantly with the level of NPLs to total loans jumping from 6,8% in 2015 to 12,8% in 2016 mainly due to the reassessment of the quality of bank's assets led by the NBRB. In addition, the volume of private credit to GDP declined by 2,4 p.p. down to 47,4% in 2016. However, banks' profitability remains positive as yearly ROA stood at around 1,6% in April 2017 and capital to assets ratio remained high at around 13,5% in 2016;
- As a result of lower consumption, a tight fiscal policy of authorities and slight appreciation of the BYR along 2016 and 2017 years, inflation rate reached 6,4% in 1Q 2017. However, taking into account historically high volatility of this metric, the Agency can expect higher figures by the end of the year;
- Following a decline in economic activity in the whole CIS region (especially the recession in Russia) and internal structural imbalances, the real GDP of Belarus declined by 2,9% y-o-y in 2016 and around 4% in 2015. However, the economy has started to recover in 1H 2017 when it grew by 1%. Moreover, we expect GDP growth to continue in a positive trend in 2017 following the positive dynamic of the Russian economy. Despite this, the growth prospects are restrained by the uncertainty in oil prices;
- The government of Belarus has a significant amount of contingent liabilities as state ownership is widespread over the whole economy. 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 corporate sector;
- Underdeveloped stock market, with market capitalization of the listed companies at 1,2% of GDP in 2016 and high concentration of trades in the 10 largest issuers;
- Relatively high yield on the 10Y USD-denominated government bond at an average of 6,8% by July 2017 reflects the market's perception of Belarus's debt repayment risks.

Stress factors:

- Negative spill-over effects from the economic slowdown in Russia combined with a high dependence from this government as creditor (weak stress-factor);
- High financial dollarization of the economy with the share of FX loans and deposits equal to 39% and 55% of total corresponding portfolio as of May 2017. Despite the positive dynamic during 2016-2017, we expect this factor to remain in place in 2017 (weak stress-factor).

Currency risks:

- High level of FX-denominated government debt equals to 45,8% of GDP, 114% of budget revenues and more than 80% of total government debt as of 2016;
- BYR 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 FX reserves remains low at USD 6,5 bn by end 2016 which covers 29,3% of the country's external debt and only 1,8 months of imports;
- Significant dependence on imported goods with imports to GDP around 63% in 2016;
- Despite the improvement over the last years, the level of net foreign assets of Belarus remains negative at -0,9% of GDP as of the end of 2016.

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Positive factors:

- Low levels of private sector debt to GDP at around 70% as of end-2016.

Restricting factors:

- The spread between interest rates on loans and deposits remains high at around 6,3 p.p. as of December 2016.

Negative factors:

- Driven by volatile inflation rates, real interest rates have fluctuated significantly over the past six years;
- 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;
- 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 the NBRB policy and poor creditworthiness of the borrowers;
- Increase of public debt metrics due to materialization of contingent liabilities of the government;
- Materialization of risks related to the current financial position of the largest creditors that can lead to a steep reduction of external financial support.

“The confirmation of the SGC and CCE ratings of Belarus reflects elevated debt metrics, risk of potential materialization of contingent liabilities, persistent banking sector risk and, despite positive dynamics, continued high levels of inflation and dollarization. Moreover, the rating assessment is still restrained by a dismal external position and negligible progress in structural reforms.

However, the high levels of debt are mitigated by the new 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 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:

<http://raexpert.eu/reports/Research report Belarus 28.07.2017.pdf>

Next scheduled rating publication: TBD in December 2017.

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RATING HISTORY:

| Date | Review reason | SGC | | CCE | |
|------------|---|-------------------|------------------|-------------------|------------------|
| | | National currency | Foreign currency | National currency | Foreign currency |
| 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 27 July 2017. 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.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.

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.