Research Report on Belarus

8 January 2021

Responsible Expert:

Denys Anokhov
Rating Analyst

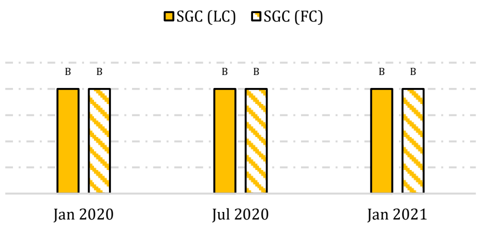
For further information contact:
Rating-Agentur Expert RA GmbH (RAEX-Europe)
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00 ext. 1212
E-mail: anokhov@raexpert.eu
www.raexpert.eu

Ratings

Sovereign Government Credit (LC)	B
Sovereign Government Credit (FC)	B
Outlook (LC)	Negative
Outlook (FC)	Negative

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Belarus

Macro indicators	2017	2018	2020*
Gross gov. debt, BYN bn	58,2	56,3	72,0
Nominal GDP, BYN bn	122,3	132	141,2
Real GDP growth, %	3,1	1,2	-0,5
Gross gov. debt/GDP, %	47,5	42,7	51,0
Deficit (surplus)/GDP, %	1,8	0,6	-3,0
Inflation rate, %	5,6	4,7	6,6
Current Account Balance/GDP, %	0	-1,8	-2,5
External debt, USD bn	39,3	40,7	40,6

Development indicators	2020
Inequality adj. HDI	0,77**
GDP per capita, USD th	19,8

Default indicator	08.01.2021
10Y Gov Bond Yield, %	6,15***

Source: RAEX-Europe calculations based on data from WB, IMF, NBRB, MFRB, Belstat, Cbonds.
* Forecast; **Data for 2019; ***Maturity in 2031.

RAEX-Europe confirmed at 'B' the credit ratings of Belarus. The rating outlook changed from stable to negative.

RAEX-Europe 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 changed from stable to negative, which means that in the mid-term perspective there is a high probability of downgrading the rating score.

Summary

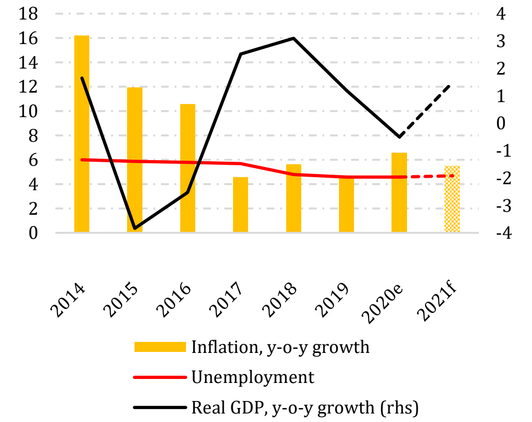
Our decision to change the outlook mainly reflects the negative trends in the financial sector, deterioration of the government finances, as well as the macroeconomic instability caused by the global pandemic and the political crisis in Belarus. Besides, the rating is still restrained by long-term structural problems, which stem from the high financial and trade dependence on Russia, inefficient state-owned corporations and elevated levels of financial dollarization.

Meanwhile, the Agency maintained the current sovereign credit ratings at 'B', due to more positive economic results in 2020 and mid-term forecasts, manageable government debt and adequate fiscal budget, as well as the favorable quality of the fiscal and monetary policies.

2020 was a year of strength tests for the Belarusian economy. First, in 1H 2020, the economy experienced shocks of a drop in production in the export-oriented oil refining and chemical industries, as well as the negative impact of COVID-19. Although strict quarantine measures were not imposed in the country, the sharp decline in consumer and investment demand, as well as transportation and logistics complications, led to a decrease in industrial production and a drop in revenues in the service sector. The sectors least affected by the pandemic were IT, construction, and agriculture, which contributed positively to GDP growth.

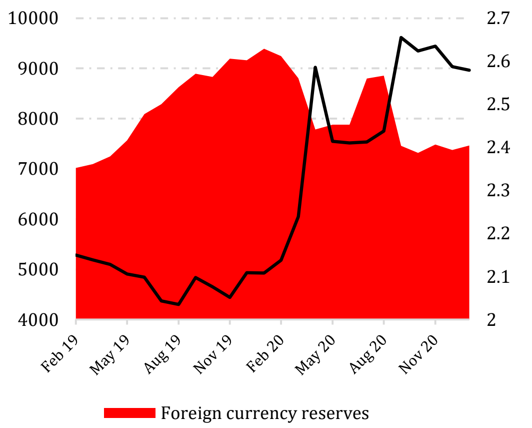
The next shock to the economy is the political crisis that occurred after the presidential election in early August. According to the officials, the current President Alexander Lukashenko has won the elections. However, the opposition and a number of countries, including the EU and the USA, did not accept these results. The authorities' harsh response to large-scale and crowded protests, as well as acts of violence against demonstrators, further aggravated the conflict and resulted in EU sanctions against some representatives of the government. The protracted confrontation poses

Graph 1: Macroeconomic indicators, %



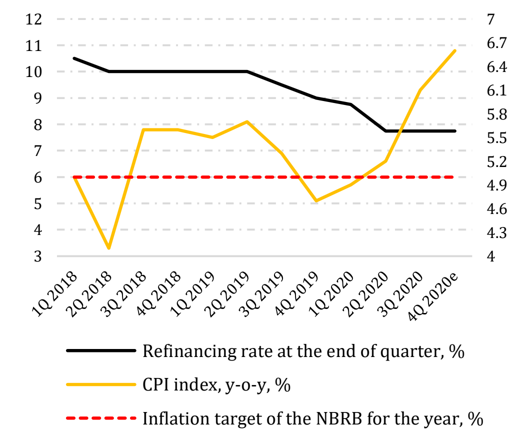
Source: RAEX-Europe calculations based on data from the IMF and Belstat

Graph 2:International reserves and FX-rate dynamic



Source: RAEX-Europe calculations based on data from the NBRB

Graph 3: Base rate vs CPI, %



Source: RAEX-Europe calculations based on data from the NBRB

risks to the stability of the financial system, and the introduction of further external sanctions can worsen foreign trade and access to international capital markets.

At the same time, relations with Russia have improved: Russia's authorities accepted the election results and expanded its financial support for Belarus. The countries agreed on the prices and volumes of energy supplies, and the budget received partial compensation for customs duty losses after Russia's tax maneuver. In general, the year-end contraction of the Belarusian economy is expected at 0,5% y-o-y, which is not as significant as in other countries of the region. In 2021, with the expected improvement of the global pandemic situation and without escalation of the political conflict, we expect economic growth between 1% and 1,5%(see graph 1).

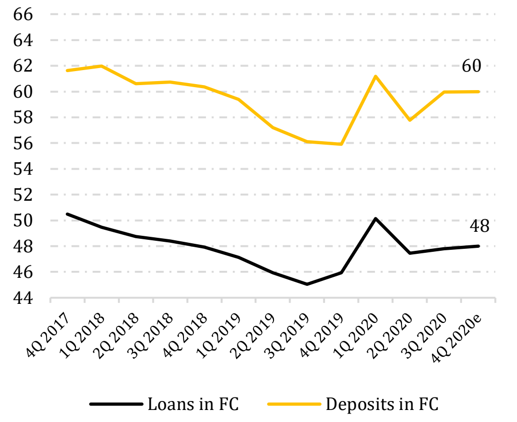
BYN exchange rate experienced pressure throughout the year. Following the devaluation of the RUB, as well as negative expectations after the president's election, increased demand in the domestic market for foreign currency led to a significant depreciation of the BYN against USD by 22,3% over the year (see graph 2). This amplified the currency risks for public finances and the banking sector. In conditions of increased demand for foreign currency, the National Bank of the Republic of Belarus (NBRB) carried out FX interventions to limit the volatility of the exchange rate. As result, this affected the stance of international reserves, which, by the end of 2020, decreased by USD 1,9 bn, or 20,5% since the beginning of the year. In addition, the loss of reserves was due to the planned repayment of government FX liabilities of about USD 3,9 bn. At the same time, the reserves are still covering more than 2 months of imports.

Despite a significant reduction in exports of the chemical industry (potash fertilizers), the trade balance was supported by exports of services of the actively developing IT sector, as well as the outpacing contraction of imports due to a decrease of capital investments and supplies of energy goods. However, the current account deficit is expected to be 2,5% of GDP at year-end, impacted by a negative trade balance of goods and a negative balance of primary income. In the medium term, the strength of the Belarus' external position depends on global demand for its exports and the state of relations with its main trade partner - Russia.

Instability in the currency market limits the possibility to conduct an expansionary monetary policy. After declining down to 4,4% y-o-y in February 2020, the inflation rate accelerated mainly due to the depreciation of the national currency. On the other hand, the weakening of domestic consumer demand had a restraining effect on the dynamics of prices. Yet, the annual inflation went up and totaled 6,6% y-o-y in October 2020, which is higher than the current monetary target of 5% (see graph 3).

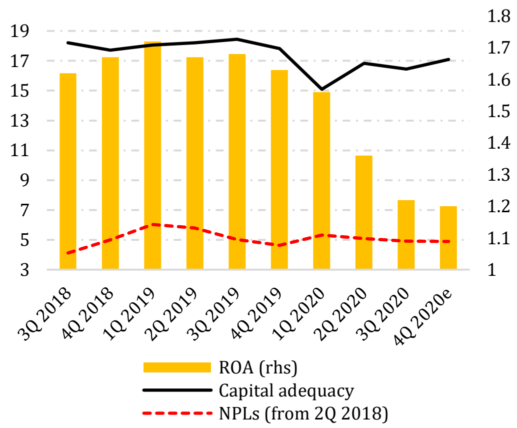
In 2020, the NBRB reduced the refinancing rate three times, bringing it to a new historic low of 7,75% but has not changed it since August, taking

Graph 4: Financial dollarization, % of total



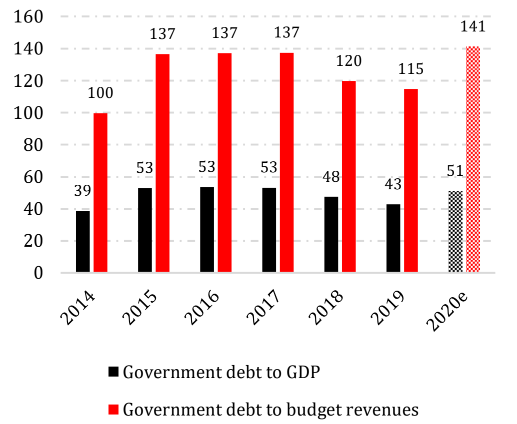
Source: RAEX-Europe calculations based on data from the NBRB

Graph 5: Financial soundness indicators, %



Source: RAEX-Europe calculations based on data from the IMF, NBRB *Starting from 1 April 2018 NBRB changed the rules and definitions for the non-performing loans and assets in order to harmonize them with the internationally accepted principles.

Graph 6: Government debt dynamics, %



Source: RAEX-Europe calculations based on data from the IMF, Ministry of finance of the Republic of Belarus (MFRB)

waiting wait-and-see position, as it awaits on the development of factors restraining the ease of monetary conditions: devaluation expectations and outflow of deposits from the banking system, which put pressure on liquidity. Moreover, the efficiency of the transmission mechanism is constrained by heightened dollarization of the economy and weak domestic capital market.

The banking sector is the most affected by the current turbulence in Belarus. As a result of instability in the country and increased devaluation expectations, the pressure on liquidity intensified from 2H 2020. From April to December, the outflow of household's funds from the banking system amounted to 18%. During the same period, FX deposits shrank by 5,2%, while their share increased to 60% due to the BYN devaluation (see graph 4). In addition, in order to prevent pressure on the exchange rate, the NBRB terminated supporting the liquidity of banks, which was provided through overnight lending. The high share of FX loans at 48% also adds pressure on banks' asset quality. While official data indicates that NPLs remain stable under 5%, there are heightened risks of potential materialization of contingent liabilities for the government, as 63% of the banking system is state-owned, with a high share of the loan portfolio concentrated on SOEs.

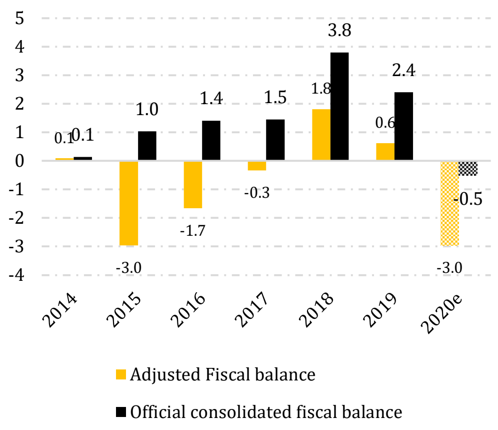
To support the banking system, the regulator took measures to soften prudential requirements, including reducing the size of minimum capital requirements, as well as the threshold on the capital adequacy ratio. The banking system posted a capital adequacy ratio of 17,1% as of November 2020, that is higher than regulatory requirements[1], and the ROE and ROA were 8,3% and 1,2% respectively for the same period (see graph 5).

The currency risk of the government's debt position is increasing. The estimated level of gross government debt as of 1 January 2021 climbed to 51% of GDP and 141,2% of budget revenues, compared to 42,7% of GDP and 114,7% respectively at the beginning of 2020 (see Graph 6). Public debt increased due to the weakening of the BYN and the raising of new borrowings on the international capital markets. During the year, government bonds totaling USD 1,4 bn were placed, and new loan agreements were signed, including USD 0,5 bn from Russia and USD 0,5 bn from Eurasian Development Bank. Taking into account the last year's tranche, the credit agreement with Russia is expected to total USD 1 bn, which will help meet the current obligations of the government and reduce volatility in the foreign exchange market.

Due to the easing of tensions with Russia, an agreement was reached on a positive change in the terms of the bilateral loan for the construction of the Belarussian NPP: the start of payments was postponed by two years, while the interest rate was reduced. Despite the favorable maturity of public debt and the low level of short-term liabilities of the government,

[1] NBRB minimum threshold 10,0% (including the conservation buffer – 12,5%).

Graph 7: Fiscal budget dynamics, % of GDP



Source: RAEX-Europe calculations based on data from the IMF, MFRB

estimated at 5,5% of GDP in 2021, the debt dynamics are highly exposed to currency risks, as according to our estimates, about 90% of the debt is in foreign currency. In this regard, we expect that in 2021 the level of the gross government public debt to GDP will reach 54% of GDP.

Deterioration of the budget with the transition to a deficit. In 2020, there was a transition from surplus to deficit in the consolidated budget, both due to the planned reduction in revenues from customs oil duties, and unforeseen expenditures related to the support of the public sector of the economy, social spending, and health care during the pandemic. According to the results of 11M 2020, the official budget deficit of the public sector did not exceed 0,5% of GDP, but taking into account off-balance sheet expenditures, the deficit could reach up to 3% of GDP by the end of 2020 (see Graph 7). Given the current economic situation, we anticipate that in 2021 the government will carry out a conservative fiscal policy, with reducing government guarantees and subsidies, as well as the cut-off of capital investments related to the Belarusian NPP.

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 the major trading partner and creditor (weak stress-factor);
- Due to the depreciation of BYN, the increased foreign currency risks pressure the stability of the banking system and government finance. The elevated level of financial dollarization of the banking system remains one of the highest in the region at 48% and 60% of loans and deposits, respectively, as of November 2020. Moreover, the currency risk is a vulnerability that significantly limits the effectiveness of monetary policy (moderately weak stress-factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Recovery of macroeconomic stability and reduction of pressure on banking sector liquidity;
- Recovery of the global economy, as well as the main trade partners, which can lead to an improvement of the external position of Belarus;
- Fundamental reform of the public sector with increased efficiency of SOEs and reduced the state's footprint;
- Outstanding and gradual downgrade of financial dollarization levels.

The following developments could lead to a downgrade:

- Escalation of the political conflict, which may lead to increased financial and macroeconomic instability;
- Deterioration of state finances due to the realization of risks: a high share of foreign currency debt, limited access to capital markets and dependence on funding from Russia, as well as the materialization of contingent liabilities;
- Significant deviation from current monetary and fiscal policies, which may lead to macroeconomic instability.

ESG Disclosure:

Inherent factors

- Quality of fiscal policy; quality of monetary policy; natural resources; natural and climatic threats; environmental threats; level of corruption, CPI; Government Effectiveness Index; quality of the business environment; position in Doing Business Ranking; level of investment in human capital, adjusted for inequality; Rule of Law Index; transparency of government policymaking Index; level of information transparency of the government; Political Stability and Absence of Violence/Terrorism Index; natural disasters, constant exposure to difficult natural conditions.

Next scheduled rating publication: 9 July 2021. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2021

For further information contact:

Responsible expert:
Denys Anokhov, Rating Analyst of RAEX-Europe
+49 (69) 3085-45-00, ext. 1212
anokhov@raexpert.eu

Reviewer:
Vladimir Gorchakov, Associate Director of RAEX-Europe
+49 (69) 3085-45-00, ext. 1211
gorchakov@raexpert.eu

Rating-Agentur Expert RA GmbH (RAEX-Europe)
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
10.07.2020	Scheduled revision of both types of ratings for the country	B	B	Stable	Stable
10.01.2020	Scheduled revision of both types of ratings for the country	B	B	Positive	Positive
12.07.2019	Scheduled revision of both types of ratings for the country	B	B	Positive	Positive
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 7 January 2021. 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 participate 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.

ESG Disclosure

We consider Environmental, Social, and Governance (ESG) risks and opportunities in the creditworthiness analysis of our Sovereign entities. The disclosure document can be found on the Agency's website in the section: ESG factors in RAEX-Europe's Credit Ratings

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.