# Research Report on Belarus

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**Responsible Expert:**

Vladimir Gorchakov
Rating Associate

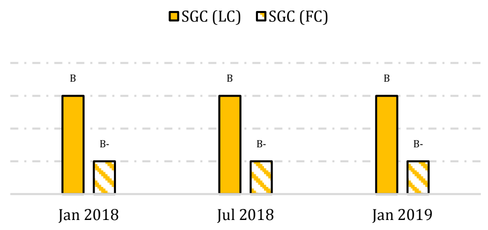
**For further information contact:**
Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00
E-mail: info@raexpert.eu
www.raexpert.eu

**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 | 2016 | 2017 | 2018f |
|---|---|---|---|
| Gross gov. debt, BYN bn | 51 | 56 | 64 |
| Nominal GDP, BYN bn | 95 | 105 | 115 |
| Real GDP growth, % | -2,5 | 2,4 | 3,4 |
| Gross gov. debt/GDP, % | 53,5 | 53,4 | 55,9 |
| Deficit (surplus)/GDP, % | -1,7 | -0,3 | -1,5 |
| Inflation rate, % | 10,6 | 4,6 | 5,6 |
| Current Account Balance/GDP, % | - | - | -2,5 |
| External debt, USD bn | - | - | 39,5* |

| Development indicators | 2018f |
|---|---|
| Inequality adj. HDI | 0,74** |
| GDP per capita, USD th | 20,2 |

| Default indicator | 18.01.2019 |
|---|---|
| 5-Year CDS spread, Bp | 364,8 |
| 12Y Gov Bond Yield, % | 7,1*** |

Source: RAEX-Europe calculations based on data from World Bank, IMF, NBRB, Ministry of finance of the Republic of Belarus, Belstat, Cbonds, Deutsche Bourse.
*3Q 2018 **Data for 2017 ***Maturity in 2030

## Summary

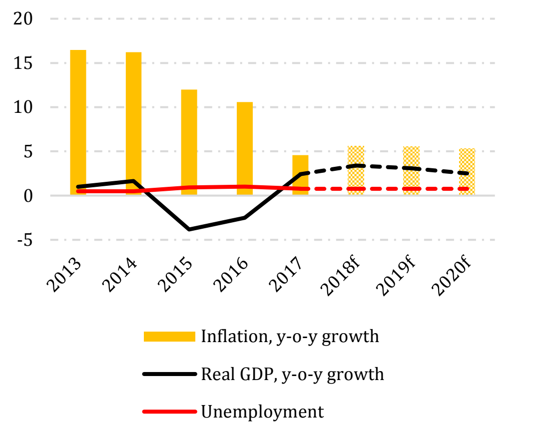
Our confirmation of sovereign government credit ratings of Belarus at ‘B’ in national currency and at ‘B-’ in foreign currency reflects the ongoing economic recovery, improvement of the banking system metrics, acceptable fiscal deficit as well as positive structure of the government debt in terms of creditors and maturity. We kept the positive outlook on both ratings due to our expectations for economic growth and gradual resolution of the “bad loans” issue in the banking system.

The ratings remained restrained by moderately high overall debt levels and its currency structure, volatile inflation, persistent contingent liabilities of the government as well as underdeveloped financial markets. We kept the currency risks due to meager level of FX reserves and a still risky status of the local currency.

**After a robust recovery, economic growth is expected to slow down in the mid-term perspective.** The Belarusian economy kept recovering after the 2015-2016 recession and is expected to grow by 3,4% y-o-y in 2018 as compared to 2,4% a year ago (see graph 1). This dynamic was supported by a positive external environment in 1H 2018, including oil prices, and increased domestic demand resulting from higher salaries over the year. However, the reduction of investments and internal consumption in 3Q 2018 indicated that the economy reached a flexing point in the economic cycle. Together with y-o-y decline in agricultural output in 3Q 2018, this led to a real GDP growth of 2,3% y-o-y as compared to 3,9% y-o-y in 2Q 2018. In addition, oil price volatility in 4Q 2018 and “base effects” can lead to a slower growth within the following quarters.

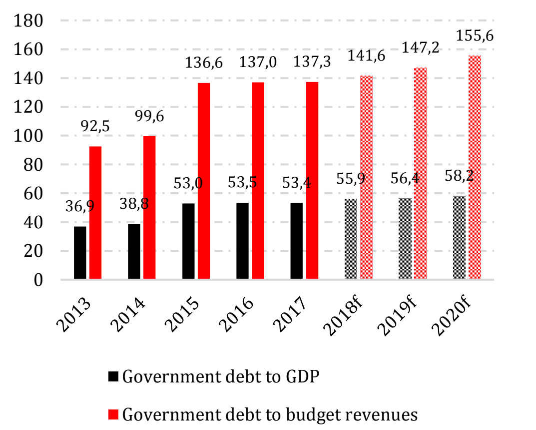
We still consider long-term growth to remain in the range between 2% and 2,5% in the following years due to structural imbalances of the Belarusian economy related to the sluggish performance of inefficient state owned enterprises (SOEs), moderately weak institutional environment and lack of competition. The government’s plans to promote economic growth through the support of the so-called “new economy” (mostly represented by IT companies) can have a limited mid-term effect due to the low share of such industries in total output. In addition, the mid-term economic growth remains dependent on the performance of the Russian economy, the main trade partner of Belarus and key source of FDI.

**Graph 1:** Macroeconomic indicators, %



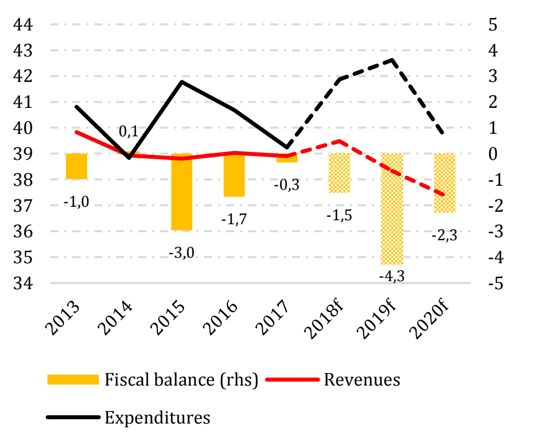

Source: RAEX-Europe calculations based on data from the IMF, Belstat

**Graph 2:** Government debt dynamics, %




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

**Graph 3:** Fiscal budget dynamics, % of GDP




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

**Debt load slightly increased while creditors' structure remains positive**. After the stabilization of debt levels within the 2015-2017 period, recent IMF estimates, which include off-balance sheet operations of the government, showed a slight increase of debt to GDP and debt to budget revenues ratios. The metrics are expected to reach 56% and 142% respectively by the end of 2018 (see graph 2), which shows an increase by 2,5p.p. and 4,3p.p. from a year ago.

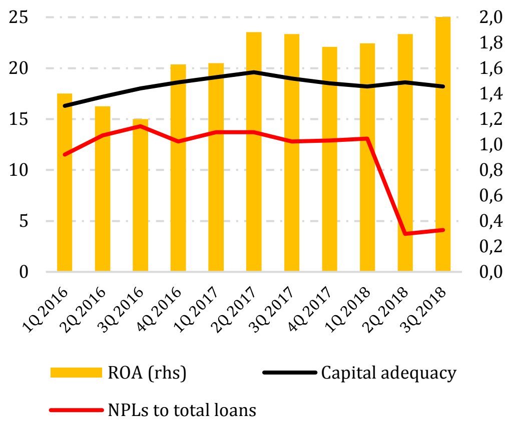
In our view, the overall debt load risks are mitigated by the favorable maturity and debt holders' structure. While the short-term external debt is estimated at 6% of GDP and 15% of budget revenues by end-2018, the prolongation or restructuring of large part of the state debt can be done with a high probability. Despite the recent turmoil in political relationships between the Belarusian and Russian governments, we still believe that potential financial support from Russia is not at risk. This opinion is based on the track record of credit support from the Russian fiscal authorities, state-owned banks and the Eurasian Fund for Stabilization and Development, which provided Belarus with financial assistance even in periods of political discrepancies.

This partly mitigates risky currency structure of the government debt, which is 90% FX-denominated, while international reserves represents only 29% of this value.

The officially announced plans of the Ministry of finance of the Republic of Belarus (MFRB) include raising funds of around USD 370 m through domestic FX-denominated bonds, and additional USD 1,5 bn on the international market, including RUB-denominated bonds on MOEX in 1Q 2019 as well as CNY-denominated bonds on the Chinese market. A successful issuance of the new instruments will increase the debt diversification by types of obligations and currency structure and, therefore, support our rating assessment. Nonetheless, the potential materialization of contingent liabilities linked to the banking sector recapitalization is still a risk factor that could cause a substantial increase of government obligations and could negatively affect the creditworthiness of the sovereign.

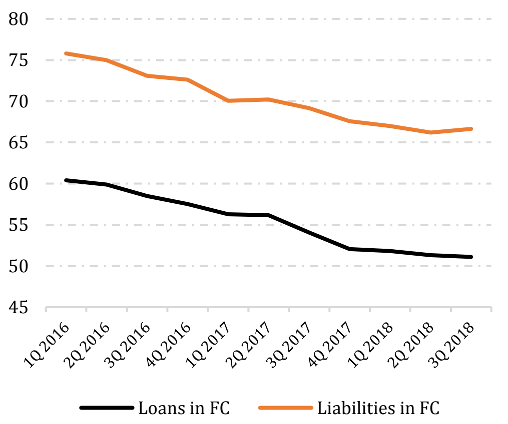
**Fiscal position is under pressure in 2019.** After a substantial improvement in 2015-2017, the fiscal performance of the government is expected to have deteriorated in 2018. According to IMF estimates, which include spending on SOE recapitalization/debt forgiveness, the public deficit in Belarus could widen up to 1,5% of GDP by end of last year (see graph 3) due to expenditures (mostly salaries) rising faster than revenues. Moreover, slower than expected economic growth and the tax maneuver

**Graph 4:** Financial soundness indicators, %



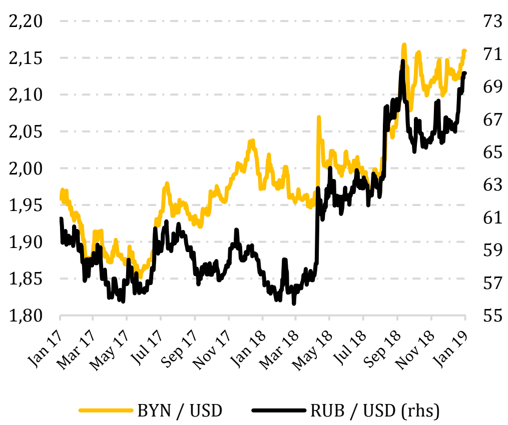

Source: RAEX-Europe calculations based on data from the IMF, NBRB

**Graph 5:** Financial dollarization, % of total




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

**Graph 6:** Dynamics of the exchange rates




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

in the Russian oil sector[1] (see below) are expected to have a strong adverse effect on the fiscal revenues in 2019. Moreover, the upcoming presidential election in 2020 increases the probability that the government will return to a looser fiscal policy with accelerated increases in salaries and pensions and additional financial support to socially important enterprises. In this sense, an unfavorable management of the budget in 2019 which could lead to wider fiscal deficits could cause the Agency to downgrade the assessment of government fiscal policy within the next revision.

The new government appointed by the president in 3Q 2018 confirmed that the policy in regards to SOEs will be unchanged. As well as in previous years, the authorities are going to concentrate on the improvement of corporate government efficiency in SOEs, instead of privatization or liquidation of loss-generating entities. Therefore, we keep our assessment of privatization capacity and plans unchanged.

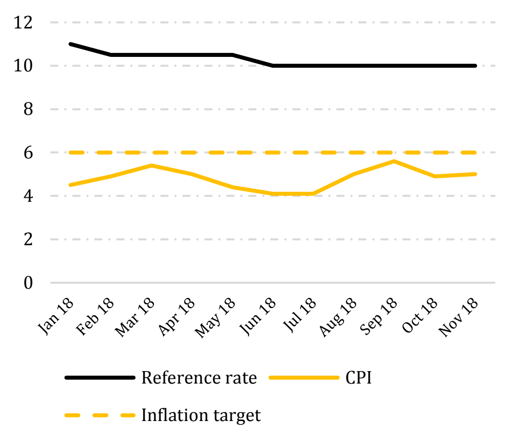
**The banking system soundness improved.** After the implementation of the asset quality reconsideration as well as the transfer of part of “bad assets” to the balance-sheet of the “Development Bank of the Republic of Belarus”, the NBRB reported a sharp decline in the level of non-performing loans to total loans ratio down to 4,1% in 3Q 2018 from 13,1% by end-2017. However, this dynamic was not confirmed by international organizations; thus, we maintain our conservative assessment in regard to the asset quality of the system. At the same time, the successful clean-up process in the local banking sector is considered as a positive step towards improving the effectiveness of the system. Profitability and capital adequacy metrics remained quite high and stable over the last years: as of 3Q 2018 the figures were 2% and 18,2% respectively.

The structural problems of the banking system remain unchanged. The state owned banks dominate the sector with a share of around 65% by end 3Q 2018, while the three largest banks accounted for 63% of total assets. Such a high concentration creates long-term risks for the system. In addition, despite a gradual reduction of the scale of directed lending, these operations deteriorate the efficiency of the banking system intermediation.

**The central bank monetary policy remained tight.** As we mentioned in our previous reports, the monetary policy of NBRB improved substantially over the last years, including gradual implementation of inflation targeting, increase of NBRB’s operational independence and ongoing liberalization of the FX-regime. The latest was supported by the NBRB’s

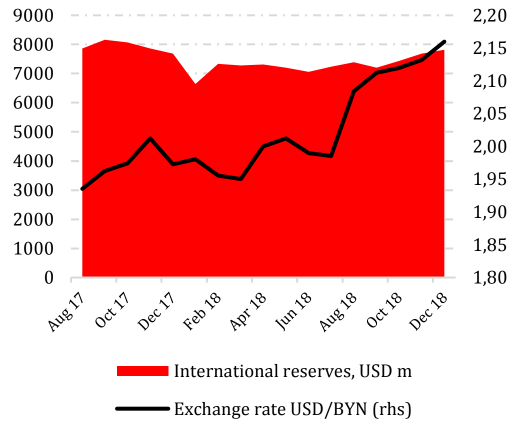
[1] Gradual reduction of custom duties on Russian oil and petroleum products (up to 0% in 2024) with correspondent increase of mineral extraction tax.

**Graph 7:** Base rate vs CPI, %




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

**Graph 8:** International reserves and FX-rate




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

July 2018 decree, cancelling the mandatory sale of foreign currency by exporters on the market. Parallel de-dollarization measures, such as increase of obligatory banks' reserves on FX-deposits led to a gradual decrease of financial dollarization over the last 1,5 years (see graph 5).

We observed a positive trend in inflation over the last three years, mostly due to stabilization of the exchange rate volatility and moderately tight NBRB's policy. However, inflation levels hiked in 2H 2018 driven by negative spill-over effects from RUB volatility (see graph 6). This caused the NBRB to keep its interest rate unchanged over 2H 2018 after two years of gradual decline. Despite the fact that preliminary data shows the inflation growth to be around 5,6% by end-2018 as compared to 4,6% in 2017, we kept our assessment of the monetary policy unchanged since the metric remained within the NBRB's target (see graph 7). In addition, the transmission mechanism of the monetary policy remains limited by financial dollarization and still persistent directed lending.

**External position remains volatile, while tax maneuver in the Russian oil industry is a key external risk for Belarus in 2019.** Belarus' external vulnerability risks remain present. The latest IMF estimates showed a wider current account deficit at 2,5% of GDP in 2018 as buoyant domestic demand and the ramp-up in construction of the nuclear power plant stimulate imports. Net foreign assets of the country, despite being positive, are still expected to be as low as 5,3% of GDP in 2018. In addition, after two years of increase in the level of FX-reserves, these remained almost unchanged over the last year, at the level of USD 7,2 bn by end-2018 which covers 29% of the country's external debt and only 2,3 months of imports (see graph 8).

The tax maneuver in the Russian oil industry will have a negative effect on Belarus' external and fiscal position. Currently, the Belarusian state-owned oil refineries buy Russian oil at a preferential price, which excludes duties. Also, the government of Belarus transfers all duties on exported refined oil products to the country's budget. As a result, the authorities expect losses from this tax maneuver to be around USD 300 m in 2019 (around 2% of budget revenues) with a gradual annual increase that could reach up to USD 2 bn in 2024. This led to a new round of political discussions between the two governments related to the compensation for the fiscal budget of Belarus. In our view, Russian authorities are not going to provide direct compensation for the country's fiscal budget. Instead, they will continue to provide new credit resources as well as restructure and prolong the current debt.

**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_18.01.2019.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.