Research Report on Belarus

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Responsible Expert:

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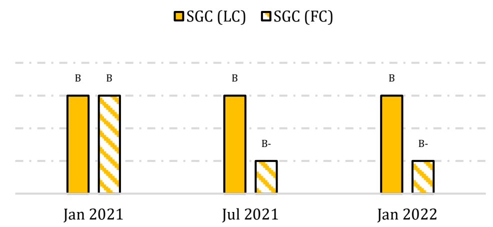
Ratings

Sovereign Government Credit (LC)	B
Sovereign Government Credit (FC)	B-
Outlook (LC)	Stable
Outlook (FC)	Stable

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Belarus

Macro indicators	2019	2020	2021
Gross gov. debt, BYN bn	56,3	72,2	78,5
Nominal GDP, BYN bn	134,7	147,0	167,5
Real GDP growth, %	1,4	-0,9	1,3
Gross gov. debt/GDP, %	41,8	49,1	46,9
Deficit (surplus)/GDP, %	0,9	-2,9	-3,9
Inflation rate, %	4,7	7,3	9,4
Current Account Balance/GDP, %	-1,9	-0,4	1,5
External debt, USD bn	40,7	42,2	42,3

Development indicators	2021
Inequality adj. HDI	0,77*
GDP per capita, USD th	21,5

Default indicator	07.01.2022
10Y Gov Bond Yield, %	10,06**

Source: RAEX-Europe calculations based on data from WB, IMF, NBRB, MFRB, Belstat, Cbonds.
*Data for 2020; **Maturity in 2031.

RAEX-Europe confirmed the credit rating of Belarus in national currency at 'B' and at 'B-' in foreign currency. The outlook on both ratings is stable. The ratings are withdrawn.

RAEX-Europe maintained the sovereign government credit ratings (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 stable, which means that in the mid-term perspective there is a high probability of maintaining the rating score.

Summary

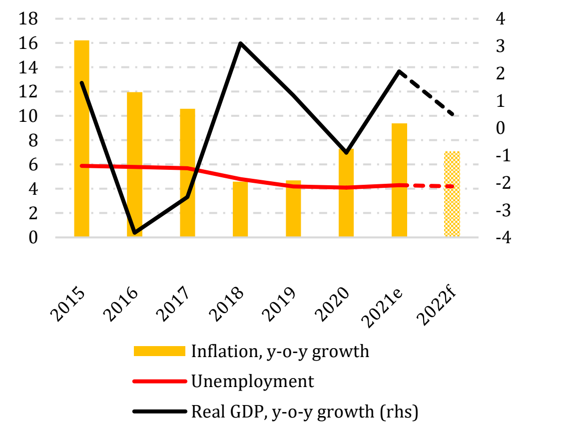
The confirmation of the ratings reflects restrained prospects for economic growth, limited by the sanctions impact, high currency risks for the government and the banking sector, and a weak external position. In addition, the ratings are constrained by increased risks of materialization of contingent liabilities.

The ratings are supported by the relatively high level of well-being of the country's population, favorable structure of public debt in terms of maturity and possibilities of restructuring and financial support from Russia.

Weakening of economic growth in the medium term. After a moderate recession in 2020, the Belarusian economy recovered in 2021 due to the support of favorable external demand and rising prices for exported products of chemical and energy industries (see Graph 1). The industrial production, which grew by 7,1% in January-October 2021 in real prices compared with the same period of 2020, as well as input of IT and communication, made the main contribution to GDP growth. The internal demand is still weak and the real disposable income increased slightly by 2,6% in January-September 2021 compared to the same period in 2020. At the end of 2021, the Agency estimates real GDP growth of 2,1%.

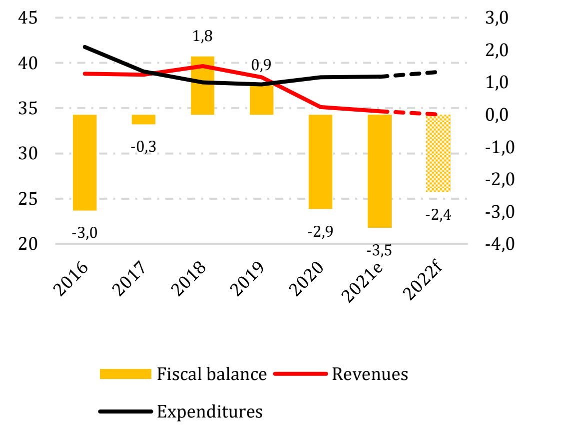
In the medium term, economic growth will be constrained by the negative effects of current external sanctions on exports to European countries, as well as limited access to international capital markets and financing from international development banks. Without further tightening of external economic conditions and new negative effects of COVID-19, moderate real GDP growth of about 0,5% is expected in 2022.

Graph 1: Macroeconomic indicators, %



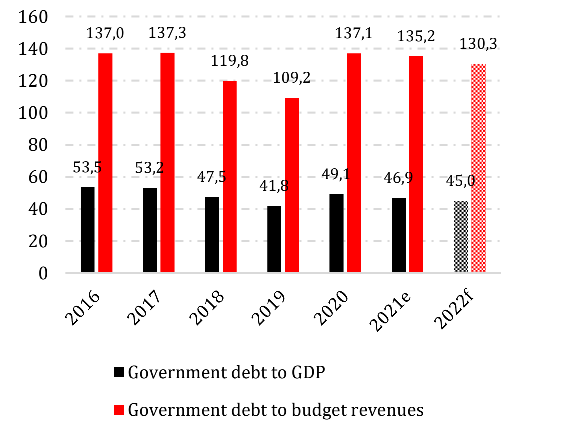
Source: RAEX-Europe calculations based on data from the IMF and Belstat

Graph 2: Fiscal budget dynamics, % of GDP



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

Graph 3: Government debt dynamics, %



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

Absence of structural reforms in the public sector of the economy, internal political tensions and pressure on the opposition worsened the World Bank's governance indicators. (Rule of Law Index dropped from -0.8 to -1, Government Effectiveness Index from -0,18 to -0,8, Political Stability and Absence of Violence/Terrorism Index from 0,3 to -0,7). With the worsening of relations with the international community, the dependence of Belarus on Russia, which remains the main partner for economic and financial stability, is increasing. In 2021, the processes of economic, fiscal and financial integration with Russia intensified, and the neighbor country provides guarantees of credit support to the Belarusian government.

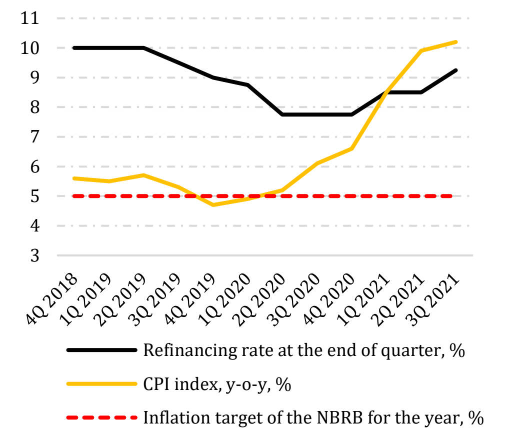
The budget of Belarus remains in deficit. In 2021, the economic recovery had a positive impact on tax revenues, primarily due to the increase in the share of income tax revenues. At the same time, the restructuring of the debt of public sector enterprises puts pressure on the government expenditures. Budget support related to COVID pandemic was moderate compared to other countries and was mainly provided in the form of extra salary payments. As a result, in 2021 the budget deficit is estimated at 3,5% of GDP (see Graph 2).

In the medium term, negative factors for the sustainability of the fiscal position are the increased pressure on government finances associated with the support of state-owned enterprises, as well as losses from the tax maneuver in the Russian oil sector. With limited options for raising external financing due to international sanctions, reducing the budget deficit seems possible only with tight control over expenditures and cuts in capital investments. The Agency expects the budget deficit to fall to 2,1% of GDP in 2022 following a reduction in public investment (in particular, the completion of a nuclear power plant).

The main risk to government debt arises from the high share of FX liabilities. At the end of 2021 the level of gross government debt compared to the end of 2020 decreased from 49,1% to 46,9% of GDP and from 137,1% to 135,2% of budget revenues (see Graph 3). At the same time, domestic government debt increased due to the issuance of government bonds, as opportunities for refinancing and placement of new government debt on the Eurobond market are limited by sanctions.

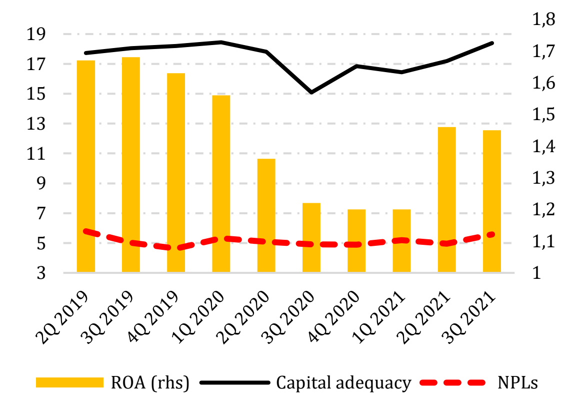
The share of FX liabilities remains high at around 90% of gross government debt, which makes it sensitive to exchange rate fluctuations and carries additional risks in case of depreciation of the national currency. Moreover, the government faces short-term yearly repayments (about 6% of GDP) and servicing mainly in FX. Nevertheless, a third of scheduled repayments is attributed to the main current creditors: Russia, China and EFSD and there is a high probability of restructuring.

Graph 4: Base rate vs CPI, %



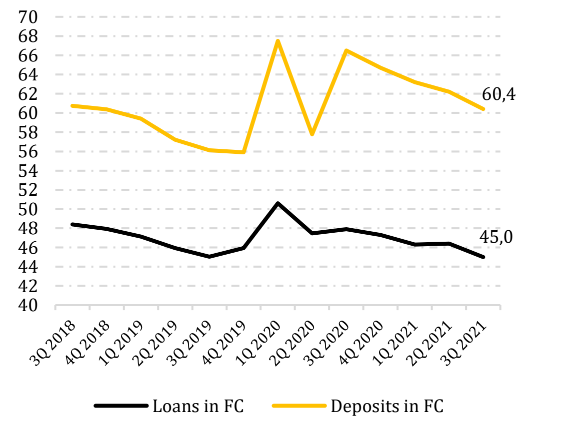
Source: RAEX-Europe calculations based on data from the NBRB

Graph 5: Financial soundness indicators, %



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

Graph 6: Financial dollarization, % of total



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

Inflation growth accelerated in 2021. Under pressure from rising global commodity prices and the weakening of BNY exchange rate, inflation continued to accelerate, reaching a record 10,2% in October 2021, with a medium-term target of 5% (see Graph 4). In 2020, the authorities suspended the transition to the inflation-targeting regime and resumed the practice of preferential lending to support state enterprises. To counter inflationary pressures, the National Bank tightened monetary policy in 2021, raising the refinancing rate by 150 basis points to 9,25%.

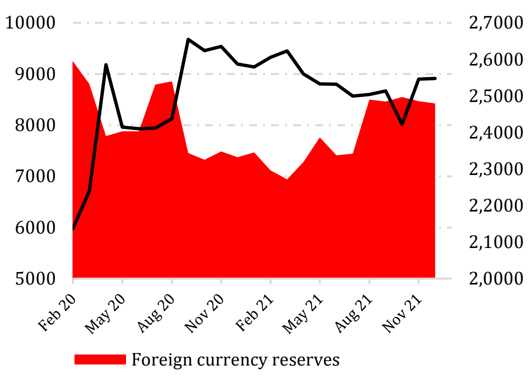
According to forecasts of the Agency, the rate of inflation exceeding the target level of 5% will remain in 2022. In turn, the practice of preferential lending along with heightened financial dollarization of the banking system and underdeveloped domestic capital market limit the effectiveness of monetary policy.

Banking sector remains stable, but credit and currency risks persist. After a turbulent 2020 year for the financial sector, the sector's performance remained stable in 2021. Due to sluggish bank activity in the lending markets, bank's total assets declined to 55% of GDP in 2021, from 62% in 2020. The NPL rate increased only slightly to 5,6% as of September 2021, compared to 4,9% as of September 2020, due to relaxed regulatory requirements for the recognition of restructured loans as problem loans. Moreover, a relaxed approach to provisioning of restructured loans allows banks to maintain profitability with ROE and ROA of 10,5% and 1,45%, respectively, as of September 2021 in comparison with 8,8% and 1,1% as of September 2020 (see Graph 5). It has also allowed maintaining a regulatory capital adequacy ratio of 18,4% as of September 2021.

Despite meeting the financial stability key indicators, the banking system remains highly exposed to foreign exchange and credit risks (see Graph 6). High share of FX loans (46%) puts pressure on the banks' asset quality and in addition, there are increased risks of the realization of contingent liabilities for the government to support the public sector of the economy, as 65% of the banking system belongs to the state, and a high proportion of the loan portfolio is concentrated in SOEs. In addition, there is uncertainty about the total amount of restructured loans, and if the situation further deteriorates, it may be necessary to create additional reserves.

The pressure on the external position slightly decreased due to a stable exchange rate and favorable export indicators. For 9M 2021, according to preliminary balance of payments data, exports of goods and services increased by 32,3%, while imports increased slightly less, by 29,6%. Export growth was due to both the increase in volume and the rise in commodity prices. As a result, the positive trade balance for

Graph 7: International reserves and exchange rate



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

9 months reached 5,5% of GDP. The net flow of direct investments into the country remains positive, but with a high share of reinvested earnings. According to preliminary estimates of the Agency, the current account surplus in 2021 is about 1% of GDP.

After a sharp fall in 2020, FX reserves have recovered after obtaining IMF special drawing rights and due to accumulation of foreign currency, and as of November 2021 amounted to USD 8,5 bn, up 13% from a year ago (see Graph 7). Improved reserves enable to cover the current needs for repayment of government foreign currency liabilities and smooth volatility in the foreign exchange market, however, their size will cover just over 2 months of imports of goods and services.

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 in this country (medium weak stress-factor);
- The level of financial dollarization of the banking system remains one of the highest among the countries in the region at 45% and 60,4% of loans and deposits, respectively, as of September 2021. 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:

- Outstanding and gradual downgrade of financial dollarization levels;
- Strengthening the external position by building up international reserves;
- Fundamental reform of the public sector with increased efficiency of SOEs and reduced the state's footprint.

The following developments could lead to a downgrade:

- Increased financial and macroeconomic instability caused by escalation of the political conflict and further violation of human rights и civil freedoms;
- Deterioration of the government finance’s position due to the realization of risks: a high share of FX debt, widening of the fiscal position, as well as the materialization of contingent liabilities;
- Worsening of the external position reflected in the shrinking of foreign exchange reserves.

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.

Drivers of change factors

- Human rights violations in Belarus against the political opposition and reporters have led to the economic sanctions, which can result in the deterioration of economic indicators and state finances.

Next scheduled rating publication: N/A. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2022.

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
09.07.2021	Scheduled revision of both types of ratings for the country	B	B-	Stable	Stable
08.01.2021	Scheduled revision of both types of ratings for the country	B	B	Negative	Negative
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 2022. 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 August 2020). 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.

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Office responsible for preparing the rating

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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.