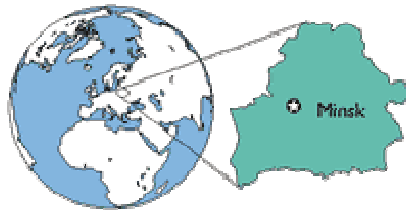


COUNTRY REVIEW

Belarus



2 February 2011

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EULER HERMES COUNTRY RISK GRADE: D

Country Risk Grades are on a scale of AA, A, BB, B, C, D
where AA is the lowest and D the highest risk.

Strengths

- Impressive economic growth in recent years according to government statistics
- Relatively moderate level of public debt (though deteriorating)

Weaknesses

- Business-unfriendly, Soviet-style political and economic system
- International isolation
- Lack of significant political and economic reforms
- High economic dependence on Russia, especially on Russian energy
- Large current account deficits
- Inadequate foreign exchange reserves
- High exchange rate risk
- Rapidly rising external debt burden
- Generally weak business environment

Country Risk Assessment

| Ratings | Belarus | | Median Grade D | Peers | | |
|---------------------------------|-----------|-------------|-------------------|------------|------------|------------|
| | Latest | Previous | | Ukraine | Macedonia | Bosnia-H. |
| Systemic Political Risk: | P4 | P4 | P3+ | P3- | P3+ | P3- |
| Systemic Economic Risk: | E6 | E6 | E6 | E6 | E6 | E6 |
| ME rating: | ME6 | ME6 | ME6 | ME6 | ME6 | ME6 |
| <i>Structure</i> | 5.7 | <i>n.a.</i> | 6.0 | 5.0 | 4.0 | 6.0 |
| <i>Policy</i> | 6.0 | <i>n.a.</i> | 5.6 | 6.0 | 4.6 | 5.6 |
| <i>Solvency</i> | 4.9 | <i>n.a.</i> | 4.3 | 6.0 | 6.0 | 3.9 |
| <i>External Liquidity</i> | 6.0 | <i>n.a.</i> | 4.8 | 6.0 | 6.0 | 6.0 |
| SBE rating: | SBE5 | SBE5 | SBE5 | SBE5 | SBE4 | SBE6 |
| COUNTRY GRADE: | D | D | | D | D | D |

Nomenclature:

Political Risk Ratings are on a scale of P1 (lowest risk), P2+, P2-, P3+, P3-, P4 (highest risk).

Economic Risk Ratings are on a scale of E1 (lowest risk), E2, E3, E4, E5, E6 (highest risk).

ME (Macro-Economic) ratings are on a scale of ME1 (lowest risk), ME2, ME3, ME4, ME5, ME6 (highest risk).

The constituent parts of the ME rating are on a scale of 1.0 (best) to 6.0 (worst).

SBE (Structural Business Environment) ratings are on a scale of SBE1 (best), SBE2, SBE3, SBE4, SBE5, SBE6 (worst).

Country Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest country risk.

Source: Euler Hermes Economic Studies

ECONOMIC STRUCTURE

| Country Profile | |
|------------------------|---|
| Capital city: | Minsk |
| Population: | 9.48 mn (2009) |
| GDP: | USD 48984 mn (2009) |
| Currency: | Belarusian ruble (BYR) |
| Form of state: | Republic in name |
| Head of government: | President Aleksandr LUKASHENKO (since 20 July 1994) |
| Next elections: | Legislative: 2012 / Presidential: 2015 |

| Major Industries (% of GDP at market prices, 2009) | Global Assumptions | 2010 | 2011 | |
|---|---------------------------|-------------------------|------|-----|
| Industry | 25.3% | Real GDP grth (% yr/yr) | 3.3 | 2.9 |
| Trade & restaurants | 10.7% | Inflation (% av) * | 1.2 | 1.4 |
| Construction | 10.7% | Dated Brent (USD/b) | 80 | 110 |
| Transport & communications | 8.9% | * Major economies | | |
| Agriculture | 7.8% | | | |

| Main Exports (% of total, 2008) | | Main Imports (% of total, 2008) | |
|---|-------|---|-------|
| Mineral products | 37.5% | Mineral products | 36.5% |
| Chemicals & rubber | 19.0% | Machinery, equipment & vehicles | 24.5% |
| Machinery, equipment & vehicles | 19.0% | Chemicals & rubber | 11.5% |
| Metals | 8.0% | Food & agricultural raw materials | 7.5% |
| Lead Export Markets (% of total exports, 2009) | | Lead Import Markets (% of total imports, 2009) | |
| Russia | 30.5% | Russia | 54.5% |
| Netherlands | 12.5% | Germany | 8.0% |
| Ukraine | 8.0% | Ukraine | 4.5% |
| Latvia | 5.5% | China | 4.0% |

Basic indicators

| Selected economic indicators | 2007 | 2008 | 2009 | 2010f | 2011f |
|---|--------|--------|--------|--------|---------|
| Nominal GDP (USD mn) | 45,276 | 60,755 | 48,984 | 54,733 | 59,696 |
| Population (mn) | 9.69 | 9.49 | 9.48 | 9.43 | 9.39 |
| GDP per capita (USD) | 4,672 | 6,400 | 5,167 | 5,802 | 6,361 |
| Real GDP growth (% yr/yr) | 8.6 | 10.2 | 0.2 | 7.6 | 5.0 |
| Inflation (% eop) | 12.1 | 13.3 | 10.1 | 9.9 | 10.0 |
| Fiscal balance (% of GDP) | 2.3 | 3.4 | -0.4 | -4.0 | -3.2 |
| Current account balance (% of GDP) | -8.0 | -10.2 | -16.4 | -15.0 | -10.4 |
| External debt/GDP (%) | 27.6 | 24.9 | 45.0 | 49.3 | 49.3 |
| External debt/Exports of goods & services (%) | 45.2 | 41.0 | 88.9 | 89.3 | 97.6 |
| Debt-service ratio (%) | 5.7 | 5.0 | 11.6 | 11.8 | 13.5 |
| Foreign exchange reserves (USD mn) | 3,952 | 2,686 | 4,253 | 2,863 | 3,000 |
| Import cover (months) | 1.6 | 0.8 | 1.7 | 0.9 | 1.0 |
| Exchange rate assumption, BYR:USD (av) | 2,146 | 2,136 | 2,793 | 2,978 | 3,176.0 |
| Exchange rate assumption, BYR:EUR (av) | 2,937 | 3,135 | 3,885 | 3,950 | 4,128.8 |
| f: CRU central forecast | | | | | |

Sources: National figures, IMF, IHS Global Insight, Euler Hermes Economic Studies

Political Stability

Belarus is officially a republic and calls its economic system a socialist market economy, but in practice the regime under President Aleksandr Lukashenko, in power since 1994, is autocratic and there is very little evidence of the development of a market economy. The opposition is oppressed, political freedoms are disregarded and the administration retains tight control over the media. Elections are usually condemned as highly flawed by international election watchdogs, typical of which were the parliamentary election in September 2008, in which opposition parties did not win a single seat, and the presidential election in December 2010, which saw Lukashenko re-elected for a fourth term with 79.7% of the vote. The latter result sparked mass street-protests which were dealt with violently, with hundreds of demonstrators arrested, including seven presidential candidates. For now, the regime looks stable and able to contain any political dissent. As a result, no significant political or economic reforms are to be expected in the next years.

Belarus' international isolation will also continue. Following an earlier flawed presidential election in 2006, the EU and the US had imposed sanctions on the country which have now been extended and intensified in response to the disproportionate crackdown on the opposition following the December 2010 election. And, even though Belarus has retained relatively close political and economic ties with Russia, relations between these two countries have also become fragile in recent years. Energy price disputes between state-controlled Russian suppliers and Belarusian buyers have become frequent, occasionally resulting in temporary energy cut-offs by Russia. Nonetheless, subsidised oil and gas supplies from Russia are likely to help Belarus to sustain its Soviet-style 'Belarusian economic model' for some time.

Economic Stability

Owing to limited structural reform since 1991, Belarus has essentially remained an outdated command economy that is reliant on the generosity of Russia which provides subsidised energy and accounts for about 30% of Belarusian exports and 55% of its imports. Government intervention into the corporate sector is overwhelming and there are administrative controls over prices and currency exchange rates.

According to government figures, annual real GDP growth has been quite impressive in recent years, averaging 9.4% in 2003-2008 and recording 0.2% in 2009 when most economies contracted, followed by 7.6% in 2010. However, the surge has been based on expansionary economic policies that are unsustainable and the temporary spillover effects of Russia's oil-driven boom. We forecast annual real GDP growth to slow to about 5% in 2011-2012.

In the wake of the global economic and financial crisis, Belarus requested financial assistance from the IMF in Q4 2008. The Fund approved a 15-month Stand-By Arrangement (SBA) in January 2009, with the size of the loan package later increased to about USD3.4bn. The programme attached to the SBA helped to constrain fiscal and monetary policy, such that the 2009 fiscal deficit was just 0.4% of GDP and 12-month inflation was reduced to a low of 5.9% in February 2010. But the government decided not to seek renewal of the IMF SBA when it expired in March 2010.

As a result, economic reform hopes have waned and economic policies have become expansionary again. Despite strong economic growth, the fiscal deficit surged to about 4% of GDP in 2010, largely owing to substantial wage rises and fiscal stimulus ahead of the December presidential election. We expect the deficit to remain above 3% of GDP in 2011. Public debt is still relatively moderate, but it has soared from just 11% of GDP in 2008 to around 30% in 2010. Further, despite administrative price controls, inflation has accelerated again to about 10% at end-2010 as price pressures have re-emerged as the authorities pump money into the economy. Real domestic credit growth surged from 7.7% yr/yr in Q4 2009 to 18% in Q3 2010. We forecast inflation to remain at around 10% in 2011.

The current account deficit widened from about 10% of GDP in 2008 to 16% in 2009 and is forecast at 10-15% in 2010-2011. In 2009 and H1 2010 less than one third of the deficit was covered by net foreign direct investment inflows. The level of foreign exchange (FX) reserves continues to be inadequate and volatile, reflecting high vulnerability to shocks such as energy price changes. At end-2010 official FX reserves stood at just USD2.9bn, 33% down from a year earlier and sufficient to cover only one month of imports or just 25% of all external debt payments (ST debt and principal repayments on M/LT debt) falling due in 2011.

Higher inflation and the large current account deficit have also put downward pressure on the Belarusian ruble (BYR), though the currency lost only about 5% against the USD in 2010 thanks to frequent central bank intervention. However, owing to the low level of FX reserves the central bank would be struggling to defend the BYR should concern about widening macroeconomic imbalances result in substantial downward pressure. Consequently, exchange rate risk is high.

Total external debt does not yet appear excessive, but it has roughly doubled in relation to GDP from 25% in 2008 to about 49% in 2010. The debt-service ratio has jumped from 5% in 2008 to a forecast 13.5% in 2011. These trends indicate that a debt-servicing problem could arise over the next few years.

Summarising, the very poor external liquidity position remains the biggest concern, causing a high vulnerability to external shocks. Exchange rate risk as well as transfer and convertibility risk, are very high.

Structural Business Environment

The structural business environment is weak and there are serious impediments to strong, sustainable growth as well as to the conduct of commercial transactions. Government regulations are excessive, subject to sudden arbitrary changes and new business regulations are often applied retroactively, deliberately causing an anti-business climate. The government intervenes in the management of private enterprises, and "unpleasing" businessmen and factory owners may be arrested. Since 2005, the government has reportedly re-nationalised a number of private companies. Other areas of weakness include a government-controlled banking system, a high level of administrative prices, legal uncertainty and poor protection of property rights. The Belarusian insolvency legislation is assessed as insufficient and ineffective; and it is applied only rarely. Insolvent companies, particularly public-sector ones, often simply continue to operate. Infrastructure is poor.

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Charts

