London,

16 September 2011

Альфа·Банк

Macroeconomic and bond market trends in Belarus: new opportunities for investors

Sergey Mukhanaw

Current macroeconomic situation in Belarus

After nearly a decade of sustainable and robust economic growth the country is facing the large FX crisis that might lead to material economic consequences. On 24 May 2011 the official exchange rate of local currency was devaluated 36% (or 56% according to other methods of calculation) against USD to 4930 from 3155. The current macroeconomic situation can be characterized with the following main features and developments:

- **the appearance of multiple exchange rates (virtually unavailable for most players official rate at 5347 BYR/USD, grey market cash rate at 7500-8000 and highly volatile grey market spot rate at 8500-10 000 BYR/USD soon to be replaced by a fixing rate at the second trading session at the local currency exchange**

- **the sharp rise in CPI to 48.5% YoY in July 2011 compared to 10% YoY in December 2010**

- **GDP growth remains high but is rapidly loosing momentum gained in the beginning of the year: 9.1% YoY in 8mo2011 while 11% in 1H2011 and 12.5% in 1Q2011**

- **real wages growth slowing to lower single digits in June from over 30% YoY in December 2011**

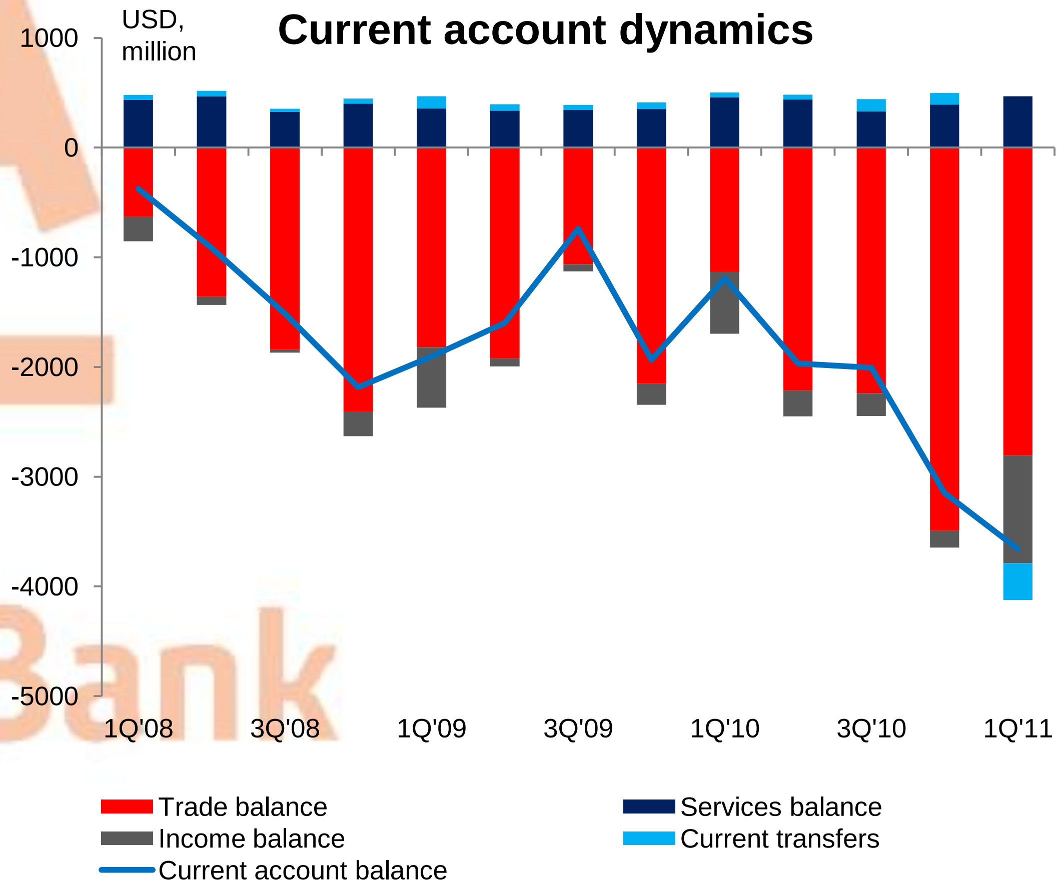
- **the external trade deficit stands high at USD 2.65 bln, however shows an important contraction from an average monthly deficit of USD780 mln in 1Q2011 to USD230 mln in 2Q2011 and even gains a positive territory of USD380 mln in July.**

- **the fiscal discipline remains high: the budget surplus in 7mo2011 amounted to BYR1.4 trln. or 1.1% of GDP vs. a yearly planned budget deficit at 3.3% of GDP**

Crisis preconditions

Альфа·Банк

The current FX crisis was fuelled by a sharp fall in foreign reserves (from around USD 6 billion as of 1 Oct. 2010 to just USD 3.8 billion as of 1 Apr. 2001) which in turn was for the most part caused by deteriorating current account deficit, and particularly widening foreign trade deficit



Crisis preconditions

The widening of the foreign trade deficit derived from the combination of the following factors:

- **rising prices of imported gas from Russia and the termination of existing discounts;**
- **rising prices of oil imports from Russia and the redistribution of customs payments for exporting Belarusian oil products sourced from Russian crude oil in favour of the Russian state budget;**
- **massive investment programs, both government and private, aimed at production modernization and energy efficiency**
- **significant growth in consumer imports in 4Q10 fuelled on the one hand by the increase in wages for the population in wake of the presidential elections in December 2010, and on the other hand – by the surge in car imports in anticipation of unification of customs duties in the customs union. (Passenger car import duties in Russia exceeded the ones in Belarus by 3-10 times). Total car imports amounted to almost USD2 bn.**
- **a slowdown in exports from Belarus, due to the gradual loss of the competitive price advantage (firstly, because of the rise of labor cost due to high pace of real wages growth and secondly, because of important share of imported components and energy in Belarusian exports)**

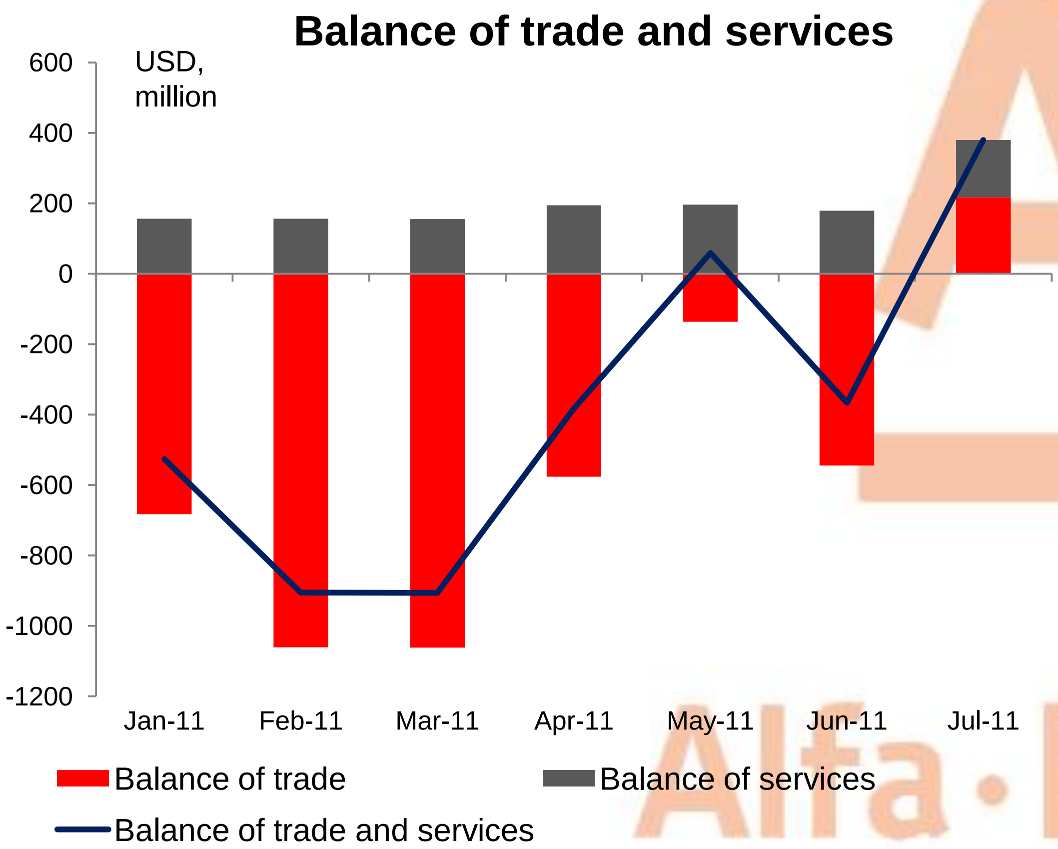
Measures undertaken to overcome the crisis

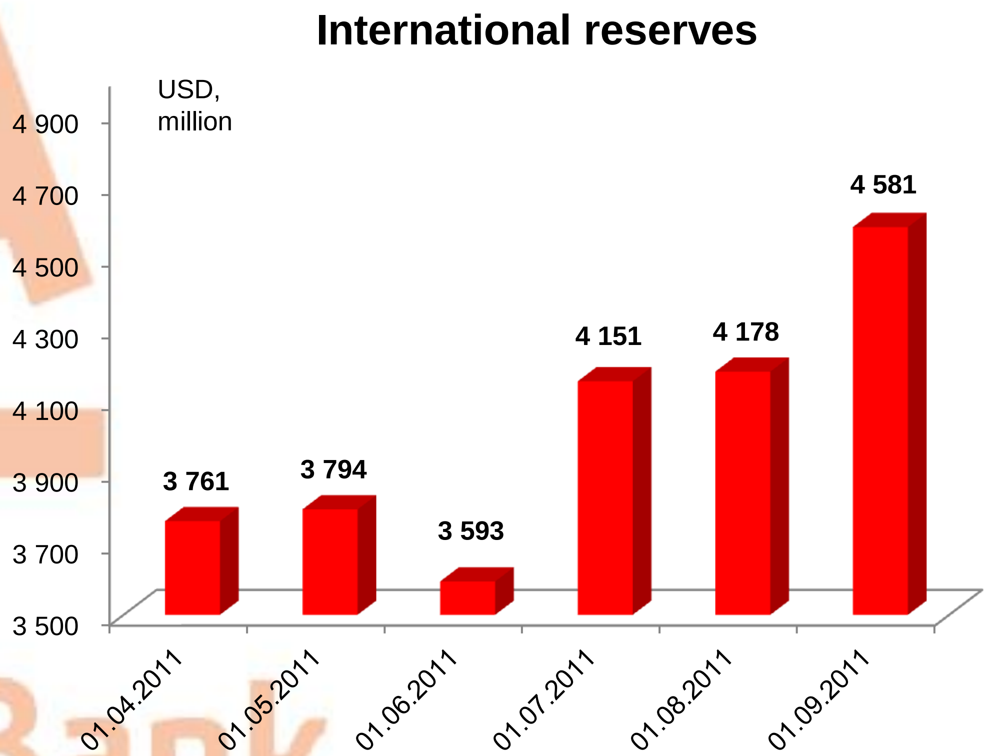
After quite a prolonged period of hesitancy, infirmity and lack of coordination the economic and financial authorities substantiated the measures to fight the crisis:

- **sharp devaluation of the local currency to promote exports**
- **administrative measures to limit imports**
- **tightening of the monetary policy (key rate has been hiked 9 times this year from 10,5% to 30% and this trend is bound to continue)**
- **strict fiscal discipline (state budget surplus of BYR 1,1 trln. or 1,1% of GDP vs. annual forecast of budget deficit of 3,3% of GDP)**
- **actual start of long announced privatization**
- **halt in real wage growth**
- **reduction of state investment programs**
- **attempt to return to single market defined exchange rate of the local currency (launch of the second trading session at the local currency exchange where the exchange rate is to be fixed based on market supply and demand)**

Current developments and macroeconomic forecast

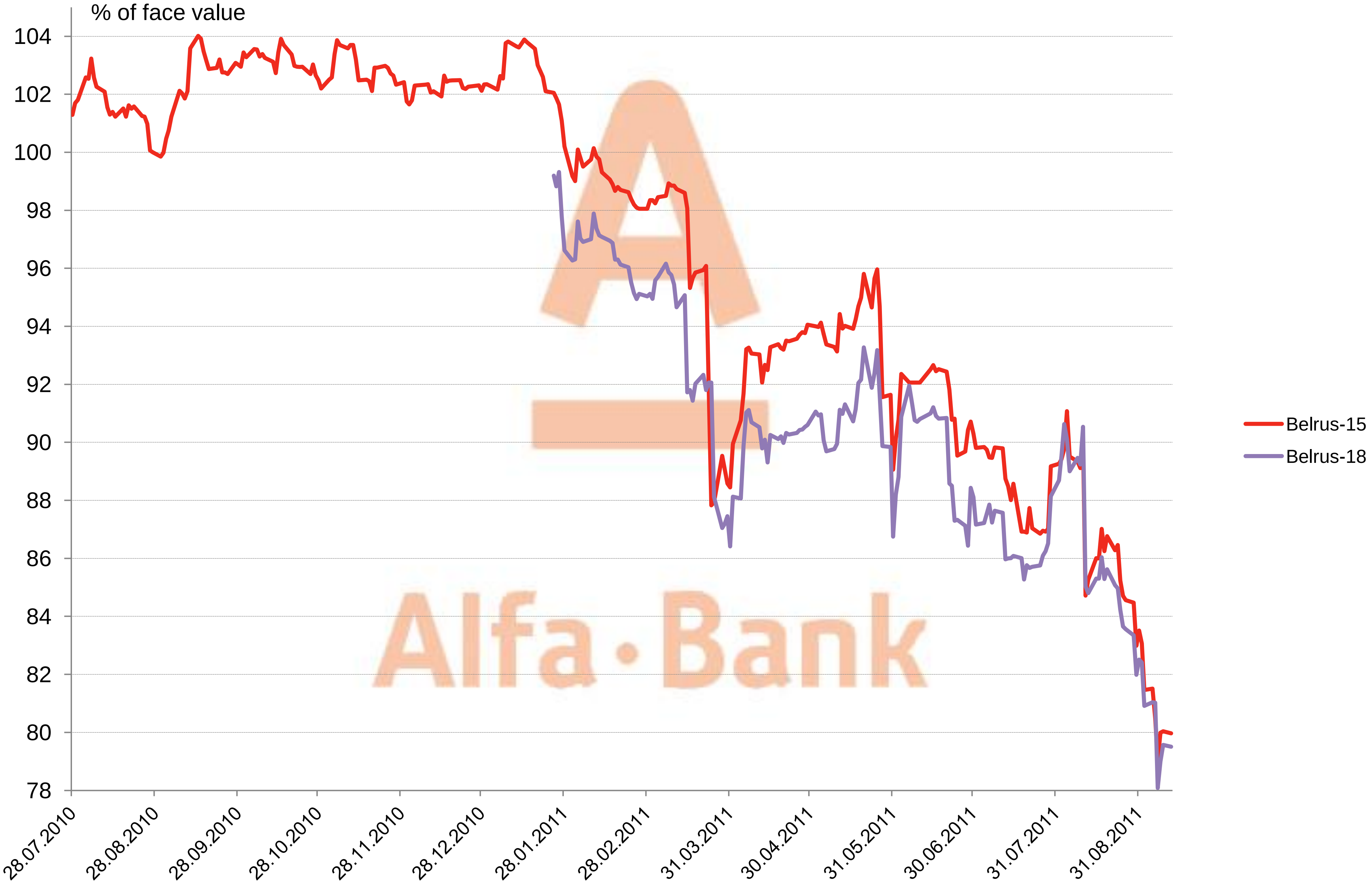
Recent measure resulted in serious improvements of foreign trade and international reserves figures:



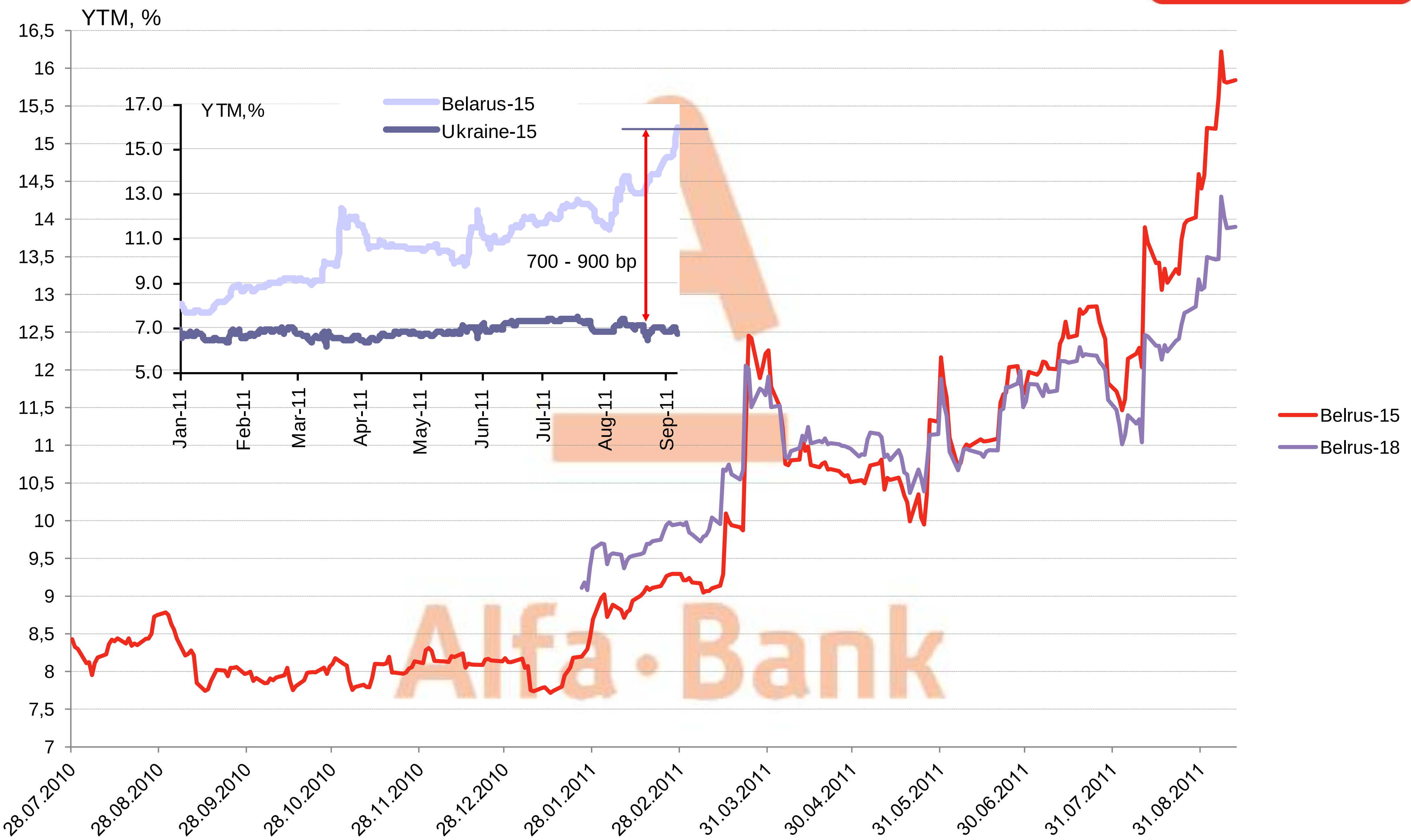


Monetary policy tightening will most likely lead to a substantial slowdown of the economy (GDP growth from 1,5 to 6% in 2011 slipping into recession in 2012 according to various estimations), but it seems to be a fair price for economy rebalancing

Belarus sovereign eurobonds price chart



Belarus sovereign eurobonds yield chart



Spread to Ukrainian sovereign risk of the same duration seems unjustified

External financing position

Recent developments in external trade balance and tighter monetary policy along with privatization plans lead to significant improvements in current external financing position and its projections for the near time horizon:

$bn	2009	2010	2011F	2012F
Financing requirement (1)	**7,9**	**10,3**	**7,3**	**5,1**
Current acc. deficit	6,4	8,8	6,0	3,0
Amortisation of medium and long-term loans	1,1	1,0	0,8	1,6
Short-term loans, trade credit and other	0,4	0,5	0,5	0,5
Financing sources (2)	**7,50**	**9,00**	**9,31**	**5,60**
FDI (incl. privatisation)	1,8	1,3	3,5	2,5
Trade credits and loans	4,5	4,3	2,5	1,0
Targeted increase in FX reserves	2,5	0,0	0,0	0,0
Eurobond issues	0,0	1,2	0,8	0,0
IFI and other bilateral aid	3,7	2,2	2,5	2,1
o/w IMF and EU	2,8	1,0	0,0	0,0
World Bank	0,2	0,0	0,0	0,0
Russia	0,7	0,0	0,0	0,0
Azerbaijan	0,0	0,2	0,3	0,3
China	0,0	1,0	1,0	1,0
EurAsEc anti-crisis fund	0,0	0,0	1,24	0,8
Financing gap (1-2)	**0,40**	**1,30**	**-1,99**	**-0,53**

It is however important to track the sustainability of positive macroeconomic trends appeared in the recent months

Estimation of the development of Belarus' external financing position

Current account:

➢ **Massive investment programs aimed among other at increasing the energy efficiency of the national economy that earlier contributed to widening of trade balance deficit will ultimately lead to lower energy consumption that represent a large share of the country's imports. The energy efficiency of the economy has already increased 9,6% in 2011 YoY**

➢ **on a short horizon energy subsidies from Russia seem set to continue (positive signals from high rank officials close to Gazprom – Beltransgaz takeover deal)**

Capital account:

➢ **privatization seems to have finally started: some 20 state companies have been sold at auctions. Possibility of sale of "family jewels" at a "fair price" has been announced:**

-**Beltrasngaz deal will most likely be closed before the end of the year at USD2,5 bn.**

- **the auction for the sale of 51% stake in mobile operator MTS is to take place on 1 Dec 2011 with the starting price of USD 1bn.**

➢ **70% of the economy (and most large industrial companies) is still state owned => large potential for further privatization**

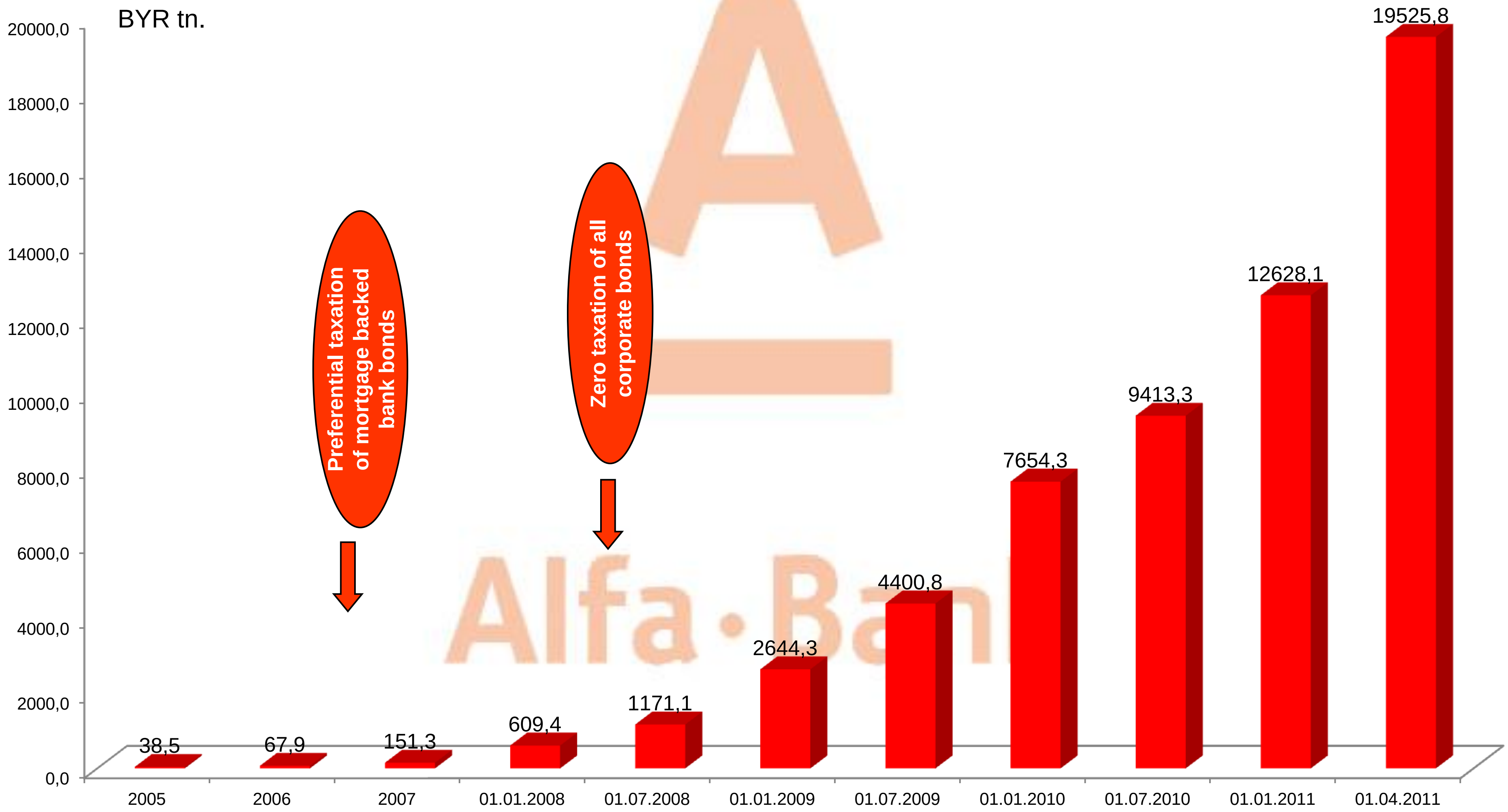
➢ **external debt is still moderate compared to peers**

➢ **authorities seem to a large extent follow the IMF recommendations (the pace of reforms is not completely satisfactory but the direction is right) => second IMF stand-by program before peak repayments in 2013 and 2014 look quite realistic if needed at that time**

Belarus financing position profile allows at the moment and with a great agree of confidence will allow to service its debt, therefore investing in sovereign eurobonds, especially Belrus-15 at current levels seems a good trade idea

Local bond market: development trends

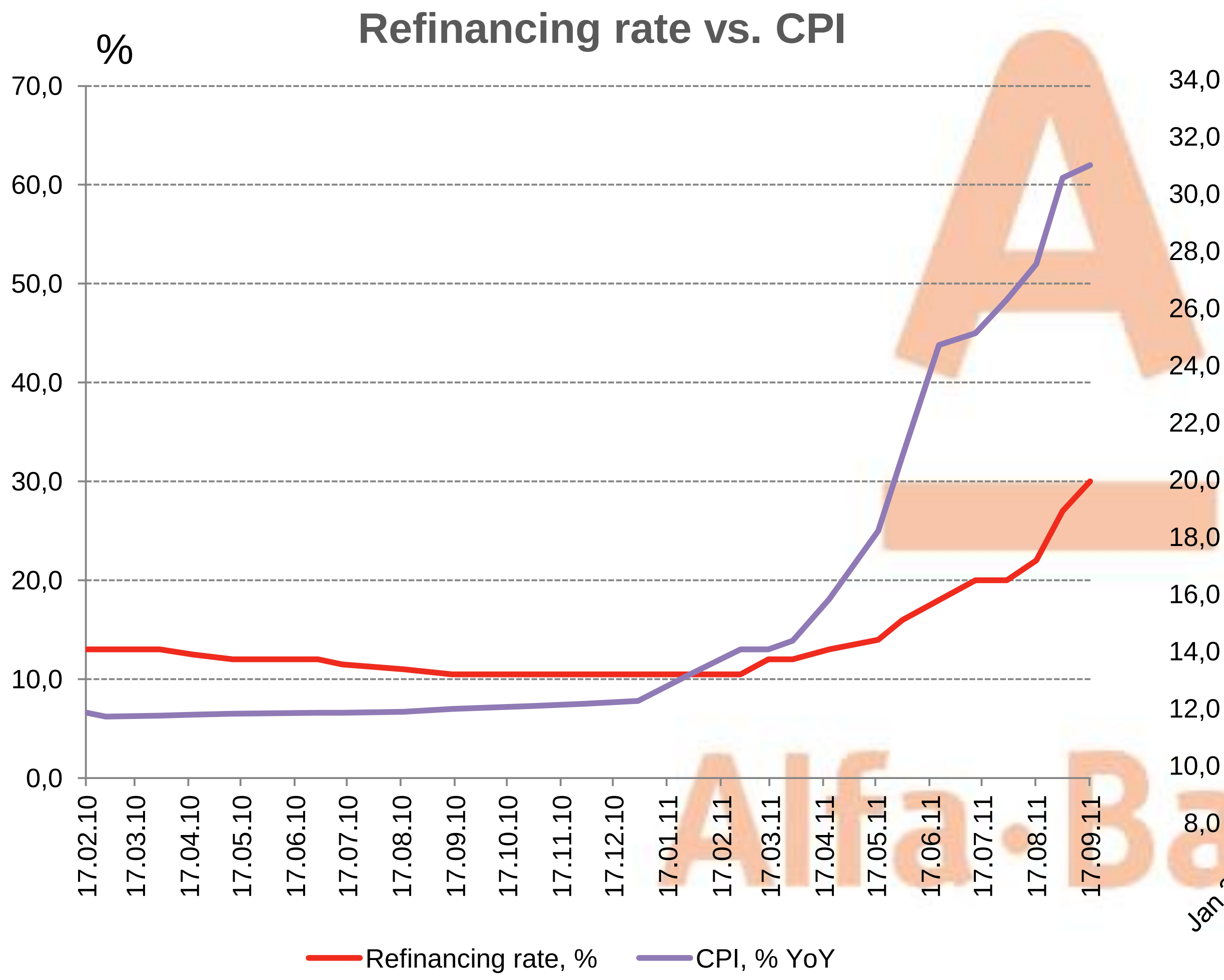
Corporate bonds is a true locomotive of the Belarusian bond market. Due to fiscal easing the size of the corporate bond market has grown 288 times in last 5 years and 23 times since the beginning of 2008 to reach over BYR 19,5 trillion

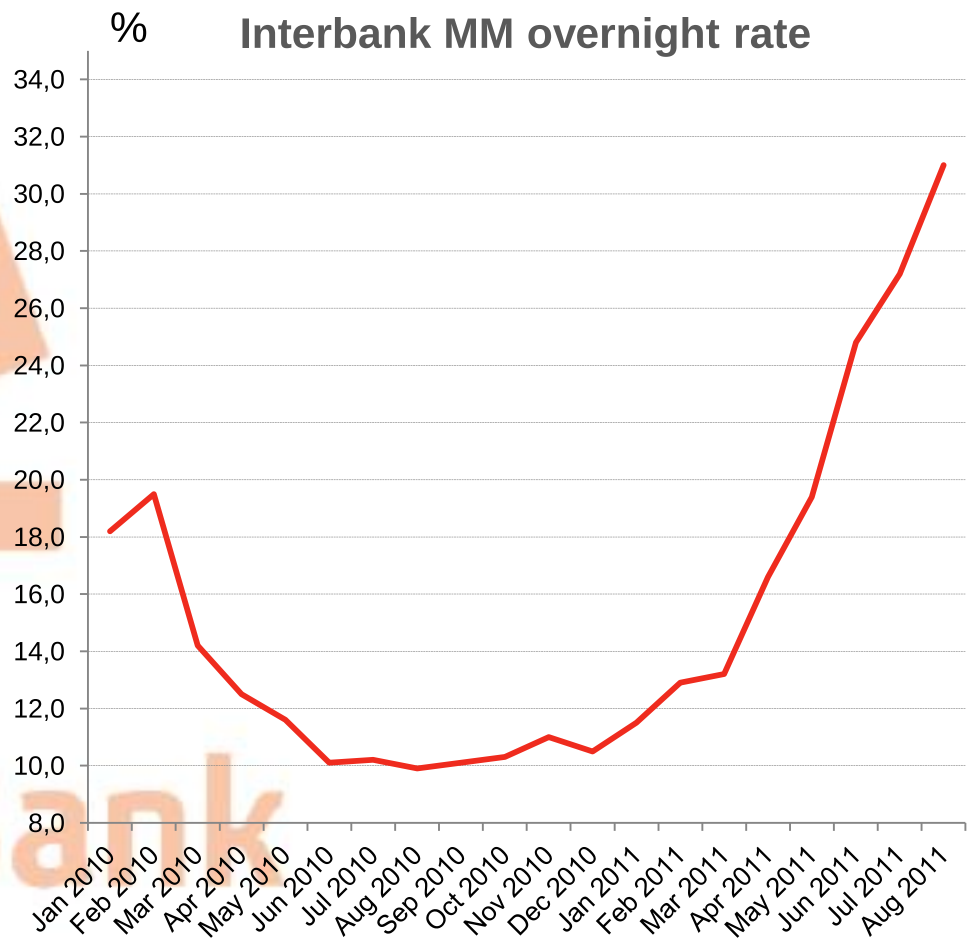


Local bond market: main characteristics

- preferential taxation
- banks play a key role on the local market both as issuers and investors
- shorter tenors of issues: 1.5-2- up to 3 years **with half-yearly or yearly put-options**
- low liquidity of the secondary market, most deal are concluded OTC
- smaller sizes of the issues: the largest corporate (non-bank) issue amounts to USD 20.0 mio
- technical character of many bond issues
- limited number of “good names” in non-banking sector

Macroeconomic background





Refinancing rates looks set to continue to grow to tap the inflation

Money market rates tend to follow the development of the refinancing rate

Local market development prospects and opportunities for foreign investors

- Further shortening of bond issues tenors
- High inflation will keep the tight monetary policy (and hence the high market rates) intact for the nearest period of time
- flexible coupon rate pegged to refinancing rate
- After liberalization of the currency market following a 2 step devaluation the local currency has a potential for appreciation
- income tax free investments
- size of issues allows to play a decisive role on the primary and secondary market. With a help of a local arranger It is possible to structure an issue corresponding to specific requirements of a club of investors

⇩

Trade idea:

- **Sale of hard currency against BYR at the market rate (2nd trading session at the BSCE)**
- **investment in BYR denominated floating rate bank bonds for the term of 1-1,5 years**
- **exit at a market at maturity or closest put-option**

⇩

Expected return – at least 20% p.a. in USD

Contact information

Director of International and Investment Banking

Sergey Mukhanaw

Phone: +375 17 217 64 68
E-mail: sergey.mukhanaw@alfa-bank.by

Deputy Head of the securities department

Anna Demchenko

Phone: +375 17 210 48 85
E-mail: bond@alfa-bank.by