

The Belarusian banking sector (2016–2021): from timid recovery to renewed crisis?

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Belarus' aging economic system of centralized state capitalism, in which state-owned banks continue to play an instrumental role through government-directed lending to state-owned enterprises, has experienced a decade of sluggish growth punctuated by recessions (2015/16 and 2020). The system has been supported by subsidized energy deliveries from Russia, which, however, have been curtailed step-by-step in recent years. Belarus' high trade and financial dependence on Russia implied that the oil price slide in 2014 to 2016 also pushed Belarus into recession. The ensuing recovery featured a degree of fiscal as well as monetary tightening (reduced directed lending, move toward inflation targeting), which cut inflation and somewhat reined in the high dollarization of deposits and lending. In 2020, stabilization tendencies were interrupted anew by the crisis triggered by the outbreak of the COVID-19 pandemic and political instability triggered by the brutal repression of demonstrations against the likely rigged presidential elections of August. While the recession of 2020 turned out to be quite mild in Belarus, Western economic and financial sanctions imposed in mid-2021 are likely to have an appreciable negative impact on the economy and banks from 2022. Given Belarus' political isolation from the West, Russia's external "lender of last resort" status looms even larger.

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Following almost two decades of relatively strong economic expansion, Belarus and its banking sector entered a decade of sluggish growth about ten years ago (around 2012), which was punctuated by recessions (2015–2016 and 2020). The country's average annual GDP growth came to 0.5% to 1% in 2012–2021. This partly reflects Belarus' strong linkages with Russia and its dominant hydrocarbon sector, whose growth also sharply slowed down in the last decade. Even more importantly, Belarus' recently lackluster economic trend is probably due to its peculiar and aging economic system of centralized state capitalism, in which state-owned banks continue to play a key role. The present study is an update of Barisitz (2016), which analyzed the evolution of Belarus' banking sector in 2012–2016; it covers developments from the crisis of 2015–2016 through to the momentous years of 2020–2021. Section 1 presents an overview of macroeconomic developments in these five years. Section 2 discusses how the banking sector overcame the crisis period of 2015–2016 and temporarily stabilized (subsection 2.1), how credit institutions and the National Bank of the Republic of Belarus (NBRB) responded to the triple crisis that hit the country in 2020–2021 (subsection 2.2), and the structure of risks banks currently face, as assessed by the author (subsection 2.3). Section 3 sheds some light on existing shock-absorbing factors (subsection 3.1) and offers a brief outlook that wraps up the study (subsection 3.2).

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1 Macroeconomic overview: the Belarusian “economic model” – from gradual winding down to crisis-triggered reactivation

The highly centralized and state-dominated Belarusian economic model may have reasserted itself during the most recent politically triggered crisis of 2020–2021, while it had been relaxed to some degree in the preceding years. Majority state-owned or state-controlled enterprises (SOEs) still account for about half of total GDP and employment; industry and banking record particularly high state ownership of assets (about 75% and 65%, respectively). State-owned banks (SOBs) have continued to be actively engaged in quasi-fiscal activities (QFAs), meaning that the banks have been implementing various state programs through government-directed lending.² This has been true especially for the two largest SOBs, Belarusbank and Belagroprombank, which together accounted for about 55% of total banking assets at end-2020. Under the authorities’ industrial policy, government-directed lending, which sets out annual growth targets for bank credit, predominantly goes to strategic actors in agriculture, manufacturing and residential construction.³

This system has benefited over decades from subsidized energy (oil and gas) deliveries from Russia, the country’s main trade and investment partner.⁴ Exports of machinery and equipment to Russia and other CIS countries, of refined hydrocarbons to the EU as well as oil and gas pipeline transit revenues from Russia to the EU have contributed to a relatively high standard of living in Belarus compared to its post-Soviet peers, like Ukraine or Georgia.⁵ Yet disagreements over drawn-out bilateral economic and political integration efforts⁶ as well as over preferential prices of Belarusian energy purchases prompted Moscow to substantially reduce implicit transfers in recent years, to the point where oil deliveries from the east were temporarily discontinued in early 2020, before a new arrangement was reached and deliveries resumed. Long-standing structural problems, sluggish investment and inefficiencies in the state-owned sector contributed to a weakening growth trend (Jajko, 2017, pp. 37–39; IMF, 2019, p. 4). On the other hand, tax benefits and light regulation have facilitated the development of a potent Belarusian information and communication sector dominated by private firms.

Given Belarus’ strong links with Russia, the oil price collapse and the Western sanctions of 2014–2015 that had pushed Russia into a mild recession also caused the Belarusian economy to contract (by 3.8% in 2015 and another 2.5% in 2016; see table 1). In relative terms, the contraction was even stronger for Belarus than for Russia. The Belarusian ruble plummeted by about 45%, and the country’s gross external debt rose to 78% of GDP in 2016 – a record level. Belarus was bailed out

² Such loans are usually extended at preferential terms (below market interest rates) to state-owned borrowers, while the banks are subsidized by the authorities to make up for the interest rate differential (Dobrinsky, 2016, p. 23).

³ Borrowers’ eventual payment difficulties are treated, in most cases, by bailouts of SOEs or (recurrent) recapitalizations of SOBs, respectively, reflecting persisting soft budget constraints (Kruk, 2016, pp. 94–96; Jajko, 2017, p. 36).

⁴ Russia accounts for about 45% of Belarus’ exports and 50% of Belarus’ imports, and the EU for about 20% of the country’s exports and imports. As regards Belarusian oil and gas imports, Russia is the overwhelming supplier (delivering almost 100% of both oil and gas purchased by the country). Together with Armenia, Kazakhstan and Kyrgyzstan, Belarus and Russia are also members of the Eurasian Economic Union, which was established in 2014/15.

⁵ For instance, according to World Bank data, in 2020, GDP per capita (purchasing power parity) came to USD 20,200 in Belarus, USD 28,200 in Russia, USD 26,700 in Kazakhstan, USD 13,060 in Ukraine and USD 14,860 in Georgia.

⁶ A “Treaty on the Union of Russia and Belarus” was signed in December 1999 by then presidents Yeltsin and Lukashenko, but its realization has been marked by very modest progress.

with about USD 3 billion in loans from the Russian government and Sberbank (together USD 2.5 billion in 2015) as well as the Russia-led Eurasian Fund for Stabilization and Development (EFSD; USD 0.5 billion granted in early 2016). A stabilization of the oil price and Russia's economic recovery also helped Belarus bounce back, but the recovery was weaker than expected (GDP growth 2017: 2.5%, 2018: 3.1%) and leveled off in 2019 (1.4%).⁷

Monetary and fiscal tightening in reaction to dwindling Russian energy subsidies were also partly responsible for this subdued growth.⁸ In 2015, the country's central bank, the NBRB, had moved from an unsustainable crawling peg regime against the US dollar to a managed float (*vis-à-vis* a currency basket comprising the Russian ruble, the US dollar and the euro), which flanked transition to money growth targeting (operational target: base money). This was followed by the ongoing transition to inflation targeting, which started in 2018; during the current state of transition, the interbank rate is used as the operational tool. Government-directed lending declined from above 40% of total lending in 2016 to about 22% in early 2020.⁹ Improved monetary policy brought inflation down from double digits in 2015 and 2016 to around 5% p.a. in 2017 to 2019, which helped raise the NBRB's credibility. Thus, a degree of fragile monetary stability was temporarily achieved (Kruk, 2021, p. 7). Current account deficits were reined in and gross external debt as a ratio to GDP slightly declined, but remained at a high level (60% to 65%); modest gross international reserves (including gold) were somewhat shored up and expanded from USD 5.4 billion (or 2.1 import months) at end-2016 to USD 9.7 billion (or 2.6 import months) at end-2019. However, wage targets for the public sector (which remained rather ambitious) were exempted from this "austerity policy" (Dobrinsky, 2020, p. 68).¹⁰

In 2020, multiple shocks hit the Belarusian economy. Due to continuing disagreements, Russia temporarily stopped oil deliveries in January to February. Then the COVID-19 pandemic struck in late March. Starting in summer 2021, months of mass protests and political instability rocked the country in the wake of the disputed elections of August, in which incumbent president Lukashenko was officially declared the winner but which were widely believed to have been fraudulent. In reaction, the EU, the USA, the UK and Canada imposed restrictive measures (mostly travel bans and asset freezes) against dozens of persons identified as responsible for repressive measures against peaceful demonstrators, opposition members and journalists in the wake of the election, as well as for misconduct of the electoral process.

Notwithstanding the multiple shocks, Minsk recorded one of the shallowest recessions in Europe in 2020: A first half-year dip of reportedly 1.7% of GDP (year on year) was followed by a modest improvement in the second semester, resulting in a full-year 2020 contraction of less than 1%, largely due to the mix of a near-

⁷ *The slowdown of GDP growth in 2019 was due to the above-mentioned deepening dispute with Russia over the price of imported hydrocarbons, which led to substantial curtailments of oil shipments, less domestic hydrocarbon processing and losses of export revenues.*

⁸ *Given Belarus' still modest ability to pay, the authorities hardly possessed the option of launching anticyclical stimuli to counter the erosion of Russian energy subsidies.*

⁹ *Government-directed lending was partly replaced by the provision of implicit government guarantees, though (Kruk, 2016, pp. 95–96).*

¹⁰ *These wage targets have traditionally been set by the president of the republic.*

absence of lockdowns (unique in Europe) and some unavoidable indirect negative effects through channels of international trade.¹¹ After sharply contracting in the first six months of 2020, the current account improved again in the second half of 2020 and was almost balanced at the end of the year. Belarus' external position was supported by its thriving IT sector, generating service export revenues of over USD 2.7 billion in 2020 and contributing to almost balancing the current account (Dobrinsky, 2021, p. 48). The same year, government-directed lending activities stopped shrinking and slightly recovered again to 23% of total lending at end-September. Thus, government-directed lending seems to have been stepped up again as a (costly) crisis response measure to support SOEs and prop up the economy (Fischer, Kirchner and Chervyakov, 2020, slides 2, p. 15).

After reattaining the pre-pandemic production level of late 2019 in the first quarter of 2021, Belarus witnessed economic expansion of 3.3% in the first semester of 2021 (year on year), stemming largely from a revival of export demand, increased prices for oil and petrochemical products and the reestablishment of Russian oil deliveries. Inflation doubled from about 5% at end-2019 to 10% (year on year) in September 2021 – far above the official target of 5%. This was triggered by rising global commodity prices, continuing homegrown wage pressure as well as high inflation expectations. The NBRB raised its key rate to 8.5% in April 2021 and further to 9.25% in July, after it had slightly reduced it (to 7.75%) in 2020. While forex interventions and debt servicing eroded international reserves by almost USD 2 billion in 2020 and the first half of 2021 (to USD 7.8 billion in mid-2021), a Eurobond issue of USD 1.3 billion in early 2020, a new Russian emergency loan of USD 1.0 billion in late 2020 and government forex bond placements of USD 0.7 billion with local credit institutions in early 2021 have supported the country's fragile ability to pay (Dobrinsky, 2021, p. 49).¹² Partly as a result, external indebtedness swelled again (to about 70% of GDP) at end-2020.¹³

The new wave of EU sanctions adopted in late June 2021 in response to the illegal grounding of a passenger airplane in Minsk and the arrest of an opposition activist and his wife are likely to have a much stronger negative impact on the Belarusian economy and banks than the largely symbolic targeted sanctions against persons involved in the violent repression of protests against the disputed elections of the previous year (mentioned above). Notably, the selective sectoral sanctions imposed by the EU cover tobacco, petrochemicals (including refined oil) and potash products as well as the security, defense and financial sectors. These punitive measures contain key exemptions weakening their impact while leaving room for possible additional tightening. Sectoral sanctions are i. a. focused on “restricting” EU imports from end-June 2021 and reducing access to EU financial markets,¹⁴ therefore the impact will only be visible over time and Belarus may have some leeway to react and redirect trade and financial transactions to soften the effect.

¹¹ *The flip side of this peculiar “policy” of largely ignoring the pandemic might be seen in a significant increase of the reported general mortality rate in the country in 2020, which may reflect under-reporting of COVID-19-related deaths. At the same time, there have been no reports of serious strains on the Belarusian healthcare system (Dobrinsky, 2021, p. 48).*

¹² *Moreover (as of early December 2021), Belarus is to receive a new EFSF loan of USD 500 million.*

¹³ *Belarus' government debt is reportedly dominated by official loans from Russia and Russian-led institutions (about 50% of the total) and from China (about 15%) (Dow Jones Newswires, 2021b).*

¹⁴ *For more details on the latter see subsection 2.2.*

Table 1

Macroeconomic indicators (2015–2021)

	2015	2016	2017	2018	2019	H1 2020	2020	H1 2021	Jan-Oct 2021
GDP growth (in real terms, %)	-3.8	-2.5	2.5	3.1	1.4	-1.7	-0.9	3.3	2.4
Consumer prices (end-year, %)	12.0	10.6	4.6	5.6	4.7	5.2	7.4	9.9	10.5
Consumer prices (annual average, %)	13.5	11.8	6.0	4.9	5.6	4.9	5.5	..	..
Current account balance (% of GDP)	-3.3	-3.4	-1.7	0.0	-1.9	-3.9	-0.4	..	..
NBRB policy rate (general refinancing rate, %, end of period)	25.0	18.0	11.0	10.0	9.0	8.0	7.75	8.5	9.25
Net FDI inflows (% of GDP)	-2.7	-2.4	-2.2	..	..	..	..	..	..
Gross external debt (% of GDP)	67.3	78.0	72.8	65.5	63.1	62.4	70.2	..	..
Gross international reserves (end-year, % of GDP)	8.5	11.3	13.9	13.0	15.0	13.8	13.3	12.4	..
- in USD billion	4.84	5.38	7.60	7.81	9.68	9.00	8.06	7.79	8.55
- in GNFS import months	1.7	2.1	2.4	2.2	2.6	..	2.6	..	..
General government balance (% of GDP) ¹	1.1	0.5	1.8	-0.3	..	..	..	..	..
Overall balance (% of GDP) ^{1,2}	-2.2	-1.7	-0.3	-1.3	..	..	..	..	..
Gross public and publicly guaranteed debt (% of GDP) ¹	53.0	53.5	53.4	51.7	..	..	..	..	..
Unemployment rate (LFS, %)	5.2	5.8	5.6	4.8	4.2	..	4.0	..	..
Memo items:									
GDP (nominal, BYR billion)	89.91	94.95	105.75	122.32	134.73	65.99 ³	147.01	78.93 ⁴	..
GDP (nominal, converted to USD billion)	56.68	47.75	54.74	60.06	64.42	28.27	60.38	30.67	..
Exchange rate (BYR/USD, period average)	1.5864	1.9885	1.9318	2.0366	2.0914	2.3343	2.4349	2.5732	2.5453
Terms of trade (change in %)	-12.4	-5.2	+3.1	+1.1	..	..	..	..	..

Source: NBRB, IMF, wiw, German Economic Team Belarus.

Note: “..” = data not available at the cutoff date.

¹ Source: IMF; latest published fiscal data on Belarus from this source (as of December 2021): end-2018.

² General government plus off-balance sheet operations (including guarantee payments, SOB and SOE recapitalizations as well as SOE debt restructuring).

³ H1 2020 (rolling four-quarter): ca. 139.95.

⁴ H1 2021 (rolling four-quarter): ca. 159.93.

In August 2021, the USA, the UK and Canada imposed comparable sectoral sanctions, while the USA also singled out 17 Belarusian enterprises in various sectors and one smaller bank (Absolut Bank,¹⁵ which accounts for about 0.2% of total banking assets) and barred them from all US dollar-denominated transactions. Furthermore, the US dollar transaction ban leaves open the possibility of imposing punitive measures also on third parties doing business with these Belarusian companies (secondary extraterritorial sanctions, an option not yet chosen) (Timofeev, 2021; Sutyryn, 2021).¹⁶ Possibly already showing a marginal impact of the above-mentioned wave of EU and Western sanctions of the summer of 2021 on top of the passing of the post-pandemic recovery of external demand, Belarusian economic expansion eased to 2.4% (year on year) in the first ten months of 2021, while it continued to be supported by the IT sector. Notwithstanding sanctions risks and negative impacts, still favorable external demand and commodity price developments slightly lifted the exchange rate of the Belarusian ruble in the second half of 2021. The rating agency Fitch in November confirmed Belarus’ long-term forex rating with a negative outlook (Fitch Solutions, 2021).

¹⁵ This credit institution is reported to entertain close links to the regime (Le Point, 2021).

¹⁶ One should add that some important emerging market trading partners of Belarus, including China, Ukraine, Kazakhstan, Turkey, India, Brazil and others, which together account for 15% to 20% of the country’s foreign trade turnover, have not joined Western sectoral sanctions.

2 Banking developments and risks

2.1 Post-2015/16 crisis stabilization

SOBs continue to account for the majority of banking sector total assets (see table 2), with Belarusbank (the big savings bank accounting for 38.8% of the sector's total assets at end-2019), Belagroprombank (14.0%) and Belinvestbank (5.7%) playing the most important roles. Foreign-owned banks make up around one-third of the sector's total assets, with Russian credit institutions comprising the lion's share: BPS-Sberbank (7.1% of total assets at end-2019), Belgazprombank (6.8%), BelVEB (Belvneshekonombank, 6.2%), Alfabank Belarus (4.0%) and Bank VTB Belarus (2.6%). Priorbank, a subsidiary of Austria's Raiffeisen Group (6.1% of total Belarusian banking assets) remains the largest non-Russian foreign-owned bank (Raiffeisen Research, 2020, p. 45)¹⁷. While the largest share of the banking sector's loans goes to SOEs and the general government, this share somewhat leveled off from 46% at end-2016 to 40% at end-2019, while the share of households as borrowers strongly expanded from 14% to 22%.

As chart 1 shows, lending as well as deposit growth were very sluggish overall in the second half of the 2010s in Belarus. After contracting sharply (by about a fifth) during the recession of 2015/16, total loans (excluding interbank loans) more or less stagnated year on year during 2017 and 2018 (in real terms and exchange rate-adjusted), before regaining momentum in 2019 (+5%). The traditionally high dollarization¹⁸ of loans spiked at above 60% during the recession (partly also due to the sharp crisis-triggered devaluation of the Belarusian ruble), before easing to around 50% at end-2019 (see chart 2). The share of forex (mostly US dollar-denominated) loans was highest (above 65%) in loans to SOEs; among the latter, there are some important exporters, but many SOEs are unhedged against exchange

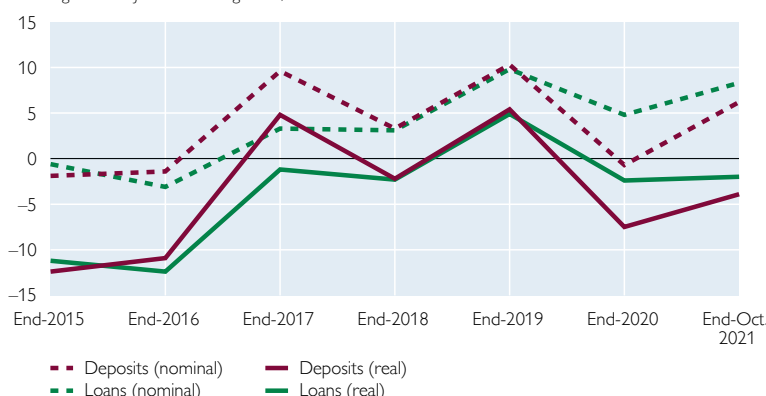
rate risks (Jajko, 2017, p. 42, p. 50). Retail lending (comprising mostly car, housing and consumer credit) stands somewhat apart in that it expanded even during the recession years and, as mentioned above, grew to over a fifth of total loans. The authorities had banned forex lending to households in 2011, and today less than 1% of retail loans are still foreign currency-denominated.

The nonperforming loan (NPL) ratio doubled during the recession of 2015/16, then remained at a relatively high level of 13% in 2017. In 2018, a new, more restrictive NPL definition was adopted, according to which the ratio came to 5% that year and then slightly declined in 2019. While a slight

Chart 1

Deposits and loans of resident sectors (excluding the interbank sector)

Exchange rate-adjusted annual growth, %



Source: NBRB.

¹⁷ Together with the above-mentioned big Belarusian and Russian banks, Priorbank features among the seven "systemically important banks" of "group I," as determined by the NBRB (NBRB, 2021a, pp. 93–94). Austrian banks' exposure to Belarus amounted to about 0.75% of their total exposure to CESEE at end-2020.

¹⁸ The high dollarization in Belarus is predominantly driven by historical factors. Past crises, hyperinflation and strong bouts of depreciation undermined trust in the local currency (Benedek, 2018, p. 2).

decline in 2019 is indeed likely given the recovery of lending that year, unfortunately, the data are not comparable with previous years.¹⁹ Evergreening practices (undisclosed restructurings) no doubt continued to play a role (IMF, 2019, p. 12). Deposits grew somewhat less sluggishly than credits, largely on account of expanding enterprise deposits. Deposit dollarization (even higher than loan dollarization) eased

Table 2

Banking sector-related indicators (2016–2021)¹

	End-2016	End-2017	End-2018	End-2019	End-2020	Mid-2021	End-Oct 2021
Total deposits (of resident sectors, excl. Interbank, BYR billion)	40.07	44.12	48.07	52.28	58.01	56.48	58.78
of which: forex deposits (incl. interbank, %)	64.3	61.7	60.2	54.3	57.0	55.4	53.7
Annual growth (nominal, exchange rate-adjusted, %)	-1.4	+9.6	+3.3	+10.3	-0.7	-2.3	+6.2
Annual growth (in real terms, exchange rate-adjusted, %)	-10.9	+4.8	-2.2	+5.4	-7.5	-11.1	-3.9
Deposits of enterprises (BYR billion)	12.58	16.63	17.53	20.81	24.60	24.90	24.94
of households	20.75	22.03	23.97	25.39	23.43	21.84	21.37
of government agencies	6.35	5.11	5.78	6.02	7.91	7.76	10.06
of the central bank	0.40	0.35	0.79	0.06	2.08	1.97	2.41
Total loans (to resident sectors, excl. interbank, BYR billion)	52.03	53.96	58.11	63.01	72.92	73.07	74.58
of which: forex loans (incl. interbank, %)	60.9	55.4	53.3	48.8	51.2	50.7	48.2
Annual growth (nominal, exchange rate-adjusted, %)	-3.1	+3.3	+3.1	+9.8	+4.8	+4.5	+8.3
Annual growth (in real terms, exchange rate-adjusted, %)	-12.4	-1.2	-2.3	+4.9	-2.4	-4.9	-2.0
Loans to state-owned enterprises (BYR billion)	15.76	15.62	16.50	17.05	21.76	20.87	20.76
of which: forex loans (%)	67.8	68.2	69.2	67.7	65.4	63.8	58.5
Loans to private enterprises (BYR billion)	11.86	12.62	13.90	14.92	18.62	18.47	19.55
of which: forex loans (%)	70.7	60.5	58.2	59.2	60.0	60.7	61.4
Loans to households (BYR billion)	7.16	9.03	11.60	14.05	15.70	15.79	16.21
of which: forex loans (%)	1.0	0.6	0.3	0.2	0.2	0.1	0.1
Claims on government agencies (BYR billion)	8.40	8.29	9.05	8.11	8.86	10.52	9.77
Claims on central bank (BYR billion)	8.85	8.40	7.06	8.87	7.98	7.42	8.29
Directed lending (share in total bank lending, %)	40.5	33.0	27.5	24.0	23.0 (end-Sep)	..	..
Loan-to-deposit ratio (%)	129.8	122.3	121.0	120.5	125.7	129.4	126.9
Nonperforming loans ² to total gross loans (%)	12.8	12.9	5.0 ³	4.6	4.8	5.0	5.5
Established reserves for assets subject to credit risk (%)	5.8	6.2	6.3	6.2	6.6	7.0	..
Liquid assets to total assets (liquid asset ratio, %)	24.6	27.4	14.4	15.0	15.8	16.3	..
Large exposures to capital (%)	176.5	160.2	166.5	159.9	189.1	160.1	..
Banks' net open position in foreign exchange to capital (%)	6.3	3.0	3.0	3.5	3.9	5.3	..
Return on assets (%)	1.6	1.8	2.0	1.9	1.5	2.0	..
Return on equity (%)	12.6	12.1	13.6	12.8	10.6	13.5	..
Capital adequacy ratio (regulatory capital to risk-weighted assets, %)	18.6	18.5	17.7	17.8	17.2	18.3	18.4
Tier 1 capital ratio (regulatory Tier 1 capital to risk-weighted assets, %)	14.2	14.0	13.6	14.0	13.9	15.6	..
Market share of SOBs (% of total assets)	66.7	64.5	64.1	63.0	64.6	..	..
Market share of FOBs (% of total assets)	30.8	32.4	32.9	33.7	32.0	..	..

Source: NBRB, IMF, Raiffeisen Research, German Economic Team Belarus.

Note: “..” = data not available at the cutoff date.

¹ Official statistics may not adequately reflect risks because of the likelihood of evergreening and of reporting shortcomings.

² Share of substandard, doubtful and bad assets in assets subject to credit risk. Separate NPL data for SOBs versus FOBs were not available.

³ Due to a new definition of NPLs from 2018 numbers are not comparable with previous periods.

¹⁹ The new definition i. a. replaces “problem assets” by what appear to be more narrowly defined “risk groups.” Restructured loans are not counted as NPLs although being subject to higher reserve requirements. According to IMF expert assessment, the new definition falls quite short of what would constitute NPLs for international comparisons (Cruz González, 2020, pp. 7–8; see also IMF, 2021).

from around 64% at end-2016 to 54% at end-2019.²⁰ As chart 3 shows, banks' profitability (ROE and ROA) somewhat improved from the low levels of 2015/16, but remained modest (also against the backdrop of some SOBs' quasi-fiscal functions). Meanwhile, capital adequacy ratios slightly eased but remained relatively high (18% in 2019, benefiting from SOB recapitalizations).

2.2 Plunge into renewed crisis mode 2020/21: COVID-19 and disputed presidential elections and Western sanctions

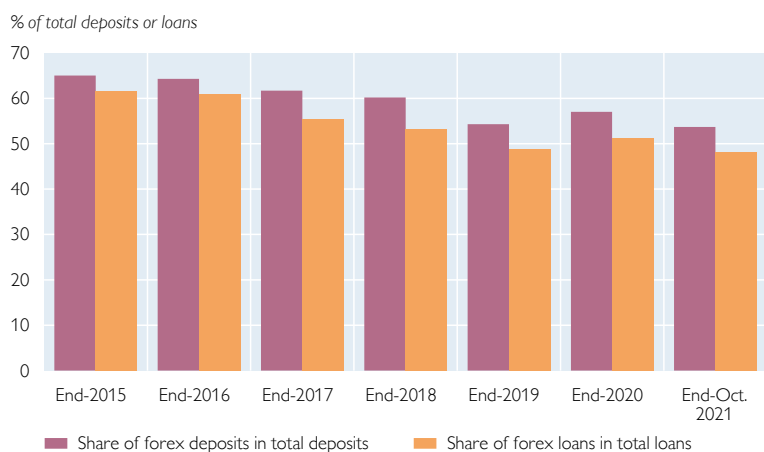
Recapitalizations and crisis response measures contributed to (temporarily) pushing up the market share of SOBs, as had happened in the recession of 2015–2016, when their share had ratcheted up 3% before gradually declining in the following years. Thus, the market share of SOBs rose again – by about 2% – during the crisis of 2020/21, reaching 65% at end-2020. While still expanding until mid-2020 (year on year), lending slowed down and contracted (in real terms and exchange rate-adjusted) by late 2020 and in 2021, yet the rate of contraction declined most recently (end-October 2021: –2%, see table 2 and chart 1). Thus, credit hardly provided a contribution to the economic growth recorded so far in 2021. Interestingly, until mid-2021, lending to SOEs and government agencies was comparatively lively, while credit to private enterprises and households gained some momentum in the summer and early fall of 2021. Forex loans continued to account for about half of total loans. The NPL ratio remained largely stable (at

around 5% according to the new definition) in 2020 and the first ten months of 2021.²¹

Deposit growth, having still slightly increased until spring 2020, strongly declined thereafter, as table 2 and chart 1 indicate. However – somewhat similar to loan growth – the shrinkage of deposits lost momentum most recently. The decrease of deposits started in May 2020 and was driven by shrinking household deposits, largely triggered by heightened uncertainty due to the outbreak of the COVID-19 pandemic and by the subsequent loss of confidence in connection with the political crisis unfolding in August 2020. Partly thanks to increased deposit interest rates, the pace of household deposit erosion

Chart 2

Dollarization of deposits and loans¹



Source: NBRB.

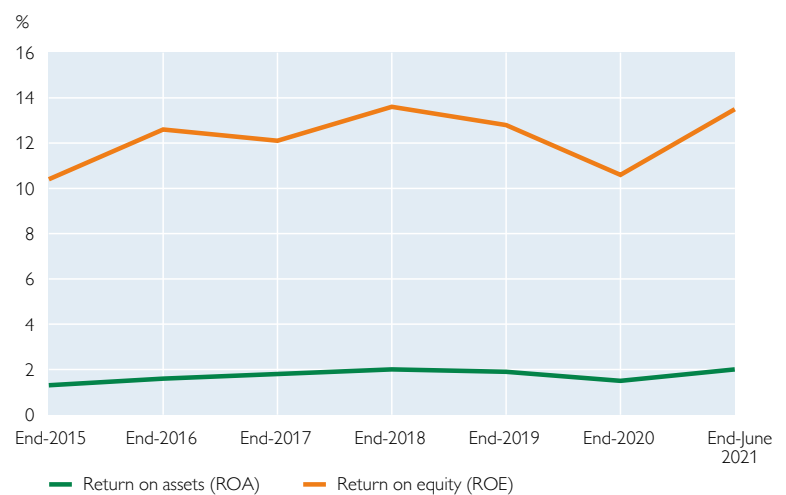
¹ Including interbank deposits and loans.

²⁰ Looking more closely at the enterprise sector, the dollarization of private sector firms' deposits turns out to be typically higher than the dollarization of public commercial enterprises' deposits, e.g. at end-2019, the two ratios were 65% compared to 54%.

²¹ In June 2020, the NBRB introduced temporary administration at Belgazprombank, the country's seventh-largest credit institution (in majority Russian ownership and comprising about 5% of total sector assets), on tax evasion and money laundering charges. The board of directors, chaired by a political rival and challenger to President Lukashenko, was suspended and a new board and chairman were elected. Thereupon, in December 2020, the temporary administration of Belgazprombank was lifted. Throughout the period of temporary administration, the bank managed to stay financially stable.

Chart 3

Banking sector profitability



Source: NBRB, German Economic Team Belarus.

slowed down in the first ten months of 2021. Retail deposit flight was furthermore offset by the expansion of enterprise, government and NBRB deposits in January to October 2021, but this did not suffice to stop the overall contraction (measured in real terms and exchange rate-adjusted). Deposit dollarization remained at a high level (about 54%) but did not spike despite temporary pressure on the Belarusian ruble. Unsurprisingly, profitability sagged somewhat (NBRB, 2021b). While NPLs (according to the new narrower definition) remained at a level of about 5% in 2020/21, forbearance measures undertaken by the NBRB during the crisis²² may understate the true situation (Fischer, Kirchner and Chervyakov, 2020, slides 10, p. 19). While slightly eroding in 2020, recorded capital adequacy regained a satisfactory level in 2021 (end-October: 18%).

The new EU financial sanctions imposed in late June 2021 focus i.a. on Belarus' three largest SOBs: Belarusbank, Belagroprombank and Belinvestbank. While they are barred from taking out loans with maturities exceeding 90 days in EU financial markets, these three banks' exposures to EU markets are very modest. If necessary, banks may get some liquidity support from the authorities as well as from the local interbank market, where subsidiaries of Russian credit institutions likely represent a stabilizing factor (about 25% market share) reinforced by their respective parent banks. In reaction, Standard&Poor's confirmed its ratings of the three banks but downgraded their outlook to negative (Dow Jones Newswires, 2021a). The current EU sanctions also ban buying Belarus government debt.

Right after their imposition, the new sanctions did not trigger a significant depreciation of the Belarusian currency nor did they cause notable deposit withdrawals. However, they have increased risks and uncertainty (Fitch Wire, 2021). Following the border crisis with Poland and Lithuania in November 2021, in which the West accused Belarus of luring thousands of migrants from Africa and the Middle East to the EU eastern border to build up pressure to force their migration west, the USA in early December 2021 matched EU sanctions on buying Belarusian government debt, and both the EU and the USA adopted additional punitive measures against Belarusian government officials.

²² These measures include the easing of a number of prudential requirements with respect to credit risk assessments for calculating capital adequacy, limiting risk concentration, formation of special reserves, regulatory capital, liquidity. The measures were introduced in the second quarter of 2020 and are scheduled to expire at end-2021 (NBRB, 2021a, pp. 87–88).

2.3 Major credit, exchange rate, liquidity, sanctions and state solvency risks

The major risks the Belarusian banking sector is currently facing include, in order of importance: credit risk (including directed lending risk), exchange rate risk and liquidity risk. Given the above-mentioned nature of banking activity in Belarus, where industrial policy and political objectives trump economic profitability or efficiency objectives, at least as far as SOBs and government-directed lending are concerned, one can assume high credit risk to be an important integral component of the system, which, as mentioned above, from time to time requires recapitalization exercises. Sanctions risk relates to the possibility of a further escalation of Belarus' conflict with the EU and the West and potential new rounds of punitive measures, which could directly or indirectly affect banks and thus likely also trigger repercussions with respect to all of the three just mentioned risks. State solvency risk is a salient underlying risk, given that the state is a majority shareholder and strategic decision maker in the banking sphere.

Credit risk continues to loom large in the Belarusian banking system given the uncertain but likely low quality of loans – notably in connection with still widespread government-directed lending, which typically follows politically determined goals instead of furthering the efficient market allocation of resources. According to NBRB information cited in Kruk (2021), the amount of potentially bad debt of the state sector is estimated at around 14% of GDP; this is very high, taking into account that the total volume of loans to SOEs and government agencies in mid-2021 came to about 21% of GDP (Kruk, 2021, p. 3). If only half of the potential bad debt was actually nonperforming, this would imply an effective NPL ratio for loans to the state sector of about one-third. Of course, one could argue that part of the burden reflects the impact of industrial policy, with “strategic actors” benefiting from subsidies and particularly lenient credit conditions. If this were the case, it would be quite an inefficient, uncertain and risky way to prop up “national champions” and buttress their competitiveness.

In any case, high credit risk will likely continue to necessitate recurrent recapitalization exercises to keep (key) SOBs (and SOEs) afloat – thus claiming a periodic “quasi-fiscal tribute.” Put in a simplified manner, in this system, SOBs are essentially tools for carrying out subsidy policies in favor of target SOEs, therefore core vulnerabilities (as far as they exist) relate to the latter²³. Elevated dollarization levels (see below) also sustain the transmission channel for currency-induced credit risk.

Against the backdrop of the Belarusian economy's continued commodity price dependence, exchange rate risk remains a key risk even though it may have lost some of its weight in connection with the progress the NBRB has achieved in moving away its monetary policy from exchange rate orientation toward inflation targeting. While dollarization remains very high on the asset and liability sides of banks' balance sheets, reflecting continued limited confidence in the domestic currency, the Belarusian ruble has recently (since 2014) sustained repeated bouts of instability-triggered devaluation, with dollarization reverting to previous (elevated) levels and financial stability not getting out of hand as a result.

The pronounced outflow of retail deposits as well as increased demand for foreign exchange (since the outbreak of political instability following the contested presidential elections in mid-2020) have underlined the importance of liquidity

²³ Most recently, additional support may have become necessary for sanctions-affected SOEs and SOBs.

risk, even if the mentioned outflows have most recently declined and have also been offset by inflows coming from enterprises and the public sector. The high level of dollarization also poses liquidity risks, as the lender of last resort function for forex deposits is limited by existing reserves.

A possible new round of EU and/or Western sanctions would most strongly affect banks if the punitive measures were related to the financial sphere (e.g. conditions for taking out loans or launching debt instruments on EU capital markets, or possible extraterritorial secondary US sanctions against specific entities), even if the actual impact may differ widely from bank to bank and depend on how the authorities react. Additional trade sanctions would affect banks indirectly (via costs imposed on SOEs or other exporters or importers).

Because of SOBs' predominant position in the banking sector and their role as instruments of government-directed lending policies, the risk of the government running into financial or other difficulties in fulfilling its bank ownership functions continues to constitute a salient business risk in Belarus. This risk is all the more serious against the backdrop of the authorities' current crisis-triggered (2020/21) delicate financial situation.²⁴

3 Shock-absorbing factors and outlook

3.1 Shock absorbers: limited fiscal resources, external “lender of last resort” looms large

There are both domestic and external factors that may act as shock absorbers for the Belarusian banking sector. At the domestic level, SOBs' capital adequacy ratios are periodically propped up by capital injections from public resources, which is why the still comfortable level of these ratios is of an artificial nature and not sustainable without continuing transfers of means within the given framework. The state budget itself, more precisely in its version of the “overall balance” (IMF, 2019, p. 33), includes such recapitalization outlays and thus constitutes an important shock-absorbing factor. While one can see in table 1 that off-balance sheet operations, including recapitalization measures, declined from about 2% to 3% of GDP during the recession in 2015/16 to about 1% of GDP in 2018, they doubtlessly must have increased again in the crisis situation most recently (2020/21).²⁵ As mentioned above, the Belarusian authorities have been able to launch a Eurobond (of USD 1.3 billion) in 2020, moreover local foreign currency-denominated obligations (of about USD 0.7 billion) were placed in early 2021. Yet the financial straits of the Belarusian state (heightened quasi-fiscal budgetary pressure from largely unreformed enterprises, waning Russian energy subsidies, renewed increase in external debt, modest level of international reserves) once again, after 2015/16, call into question the solidity of the domestic shock absorber.²⁶

²⁴ This recalls quite similar findings related to Minsk's precarious financial situation referred to in Barisitz (2016, p. 47), in that case related to the impact of the recession of 2015/16.

²⁵ IMF staff reports appear to be a very reliable source for estimates of the size of these quasi-fiscal activities (QFAs). Unfortunately, by December 2021, no new IMF Article IV Consultation and Staff Report on Belarus containing these data had been published since the 2018 report (published in January 2019). Therefore, the last IMF QFA estimate available relates to the year 2018.

²⁶ Belarus' public debt came to BYR 57.8 billion at end-2020 (about 40% of GDP). 83% of total public debt constituted external debt, which amounted to USD 18.6 billion. According to Fitch, at least for 2021, sovereign forex debt repayments looked manageable at USD 2.8 billion, with about half of redemptions owed to Russia (Reuters, 2021).

Once again, this points to external support as the second major supporting pillar of the country's economy and its banking sector. Sources of external support can principally be financial assistance from the IMF or financial assistance from Russia directly and/or from the Russia-led EFSD or from other external sources (e.g. China). Belarus could also tap Russian capital markets (Dow Jones Newswires, 2021b). An IMF loan currently appears to be out of question (given the sanctions stand-off with Western countries which are the Fund's major shareholders); however, in August 2021, Minsk did receive about USD 0.9 billion from the IMF under its new SDR program to support emerging markets in the global post-COVID-19 economic recovery (Le Figaro, 2021a). This helped provide a modest boost to Belarus' international reserves, which moved back to USD 8.5 billion at end-August 2021, a level last seen in mid-2019.²⁷

While disputes with Russia have been frequent in the past – in early 2020 even triggering a spectacular, if short-lived, halt to oil deliveries – at critical turns (e.g. in 2015/16), Belarus' big eastern neighbor has provided assistance to Minsk to stay financially afloat. Although Lukashenko has repeatedly and successfully played off Russia against the West in the diplomatic arena in the past, since the brutal repressive measures of 2020, tensions with the West have reached a point where support from Moscow appears the only substantial option left for Minsk for the time being. This unprecedented degree of dependence on Moscow may paradoxically bolster Belarus' creditworthiness because Russia's "lender of last resort" quality seems even more unequivocal than in the past.

Indeed, equipped with twin surpluses (budget as well as current account) and boasting modest external liabilities coupled with generous international reserves that have lately attained new record levels, Russia is financially well suited to lend its small eastern Slavic neighbor a helping hand, should it perceive the need to do so. And as long as Russia remains in a tense standoff with the West and as long as Belarus remains a valuable and loyal geostrategic partner, Moscow is likely to be sustaining its support for Minsk. Given the likelihood of Russian assistance, Belarus' international reserves will probably not shrink substantially in the near future (Luzgina, 2021, p. 13). In September 2021, an agreement on deeper economic integration between Russia and Belarus was signed, providing for harmonization of various policy areas between the two neighbors (for more detail see section 3.2). Parallel to the agreement, new Russian financial support is reportedly being discussed, although the details are not yet clear.

3.2 Prospects: high short-term vulnerability, costly muddling-through probably unsustainable in the long run

While Belarus seems to have overcome its surprisingly shallow COVID-19- and political instability-related recession of 2020, short- and medium-term prospects appear subdued against the backdrop of weak productivity, lingering domestic political instability and uncertainty, coupled with important, if selective, Western sanctions (since mid-2021), whose impact will likely become clearer in 2022. The Russian economy seems to have gained some steam again, having returned to a growth path in 2021 and thus resumed its role as an "economic locomotive" for Belarus, and the EU is also recovering from its deep COVID-19-triggered economic

²⁷ The country's international reserves have held this level through December 2021.

contraction of 2020. The traction of the EU's recovery for Belarus and its banks will of course be much more modest (or even nonexistent), given the expected influence of the sanctions. Saddled with these numerous domestic and external uncertainties, including the possibility of a new flare-up of the pandemic, the prospects for a sluggish recovery are not likely to provide any essential stimulus to the banking sector in the medium term. Moreover, a further escalation of Belarus' conflict with the West, which cannot be ruled out, might trigger another round of sanctions, rendering the outlook even more fragile.

Integration agreements were signed in September 2021²⁸ to deepen economic relations with Russia in the coming years within the framework of the above-referred to Union Treaty of 1999. These agreements, which provide i.a. for a harmonization of tax and customs administration, monetary policy, payment and settlement systems and labor laws, might open up new opportunities for Russian firms in Belarus' market, e.g. to acquire state-owned assets. The adoption of Russian practices might also imply that some branches in Belarus will have to shift to a more market-based system, which may well run counter to the local tradition of heavy-handed state interventionism including pervasive public ownership, government-directed lending, wage targets, etc. (BOFIT, 2021; Le Monde, 2021). In December 2021, Russia allowed Belarusian companies access to Russian state tenders (TASS, 2021). While it is clear that the authorities in Minsk prize continued uninhibited access to inexpensive natural gas supplies from Russia in the years ahead in order to prolong the functioning of their economic model, it is not yet clear to what extent they might be willing to sacrifice their control of strategic SOEs and SOBs, directed lending strategies, interventionist targeting and other essential model components. Possibly, a compromise might be found and muddling-through strategies, tolerated or supported by Moscow, might be maintained for another couple of years. Ultimately, however, such strategies will be unsustainable.

²⁸ Roadmaps were signed in early November 2021 (*Le Figaro*, 2021b).

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