POLICY BRIEFING 08|2020

German Economic Team
BELARUS

Banking Sector Monitoring Belarus

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Summary and outlook (1/2)

- The **size of the banking sector has remained rather stable** over the last years, and is smaller than in Russia and Poland, but larger than in Ukraine.
- The **sector continues to be dominated by state-owned banks**, which control 65% of the market. Russian-owned banks play with 22% also an important role. That leaves limited space for private (incl. Western) banks.
- **More than half of the banks have a market share of less than 1%**; against the background of challenges posed by COVID-19 and recent political turbulence, this poses questions about their long-term future.
- As state-owned banks tend to lend to state-owned enterprises, the role of **lending to the private sector is underdeveloped**, even though it has slightly increased until 2020.
- Recently, after years of reduction, the **amount of directed lending is on the rise again**. This might smooth real activity in the short-term, but comes at significant financial costs to the banking sector.

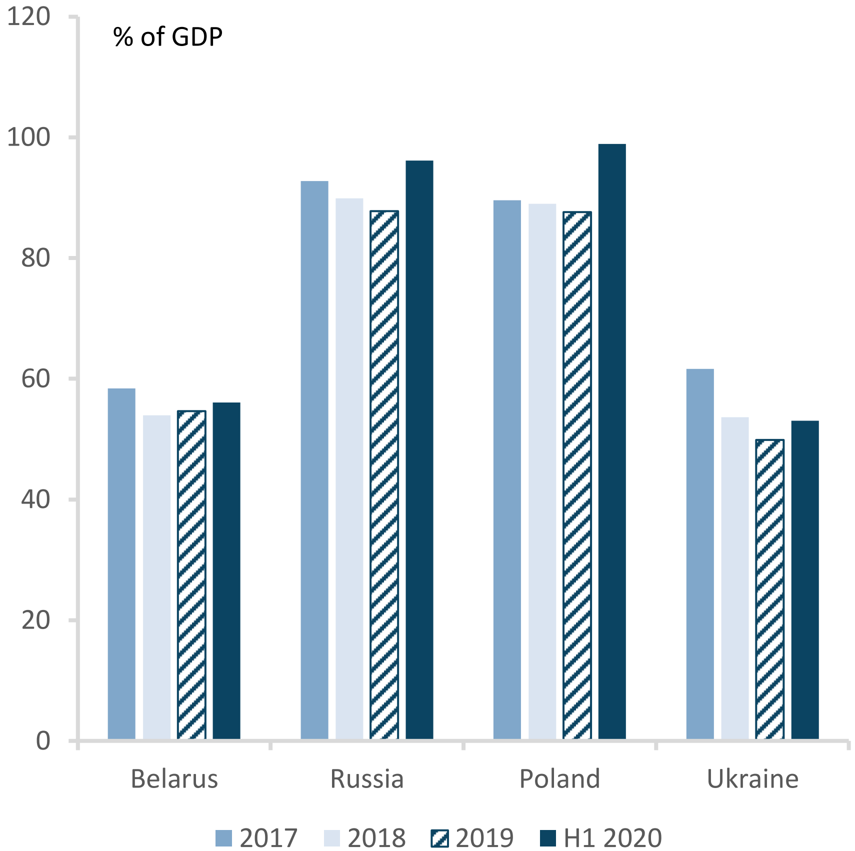
Summary and outlook (2/2)

- The system is **well-capitalized and profitable** so far, but this will likely worsen going forward.
- Increased economic uncertainty due to COVID-19 as well as the political situation cloud the outlook of the sector: **liquidity situation is tense** and a possible **deterioration of solvency indicators** (i.e. increasing NPLs from a low level) pose a credible threat.
- **High exchange rate volatility** coupled with **limited FX reserves** pose a danger to the banking system, especially as **dollarization remains high and is increasing once again** due to a rising uncertainty.
- External debt exposure is significant and **refinancing options are likely to remain limited** and will become more costly going forward**.** This is also reflected in the **worsened rating outlooks** for large banks and the sovereign.
- The **length and the deepness** of these developments is a direct function of the period of increased uncertainty, with risks increasing over time.

Content

1. Bank assets in a regional context

Bank assets



Source: National Banks, own calculations; end of period
Note: Data for Belarus is based on the audited bank balance sheets, aggregated by the National Bank

Bank assets

- Declined from 58.4% of GDP in 2017 to 54.6% in 2019
- Decline mainly due to faster growth of GDP during this period (2016-2019)
- However, indicator increased again during 2020 to 56.7% (01/10/20)
- Reasons: increase of lending and slowdown of nominal GDP growth during COVID-19 crisis

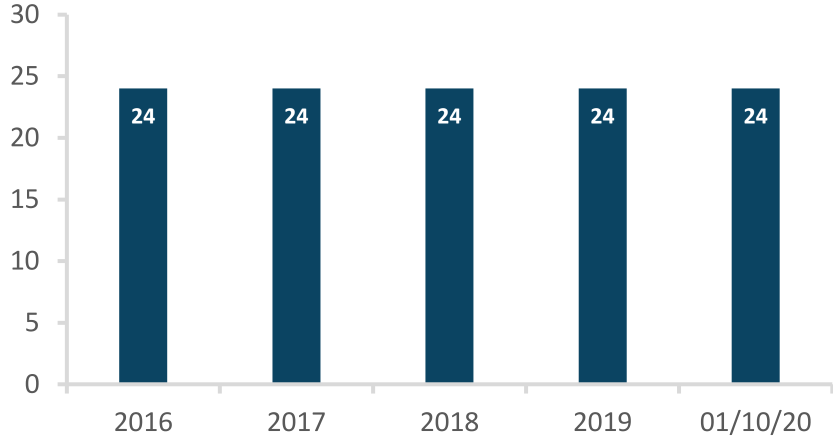
Regional Comparison

- Belarussian banking system much smaller than Russian and Polish system, but bigger than Ukrainian
- Similar trends of asset decline and recent increase in Russia, Poland and Ukraine

➢ **Increase of bank assets to GDP ratio during COVID-19; unclear, if trend will continue**

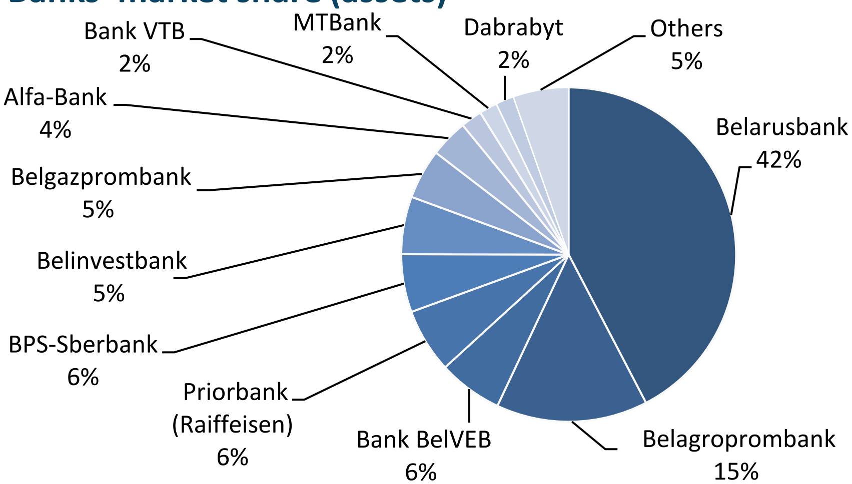
2. Number of banks and market shares

Number of banks



Source: NBRB, own calculations; end of period

Banks‘ market share (assets)



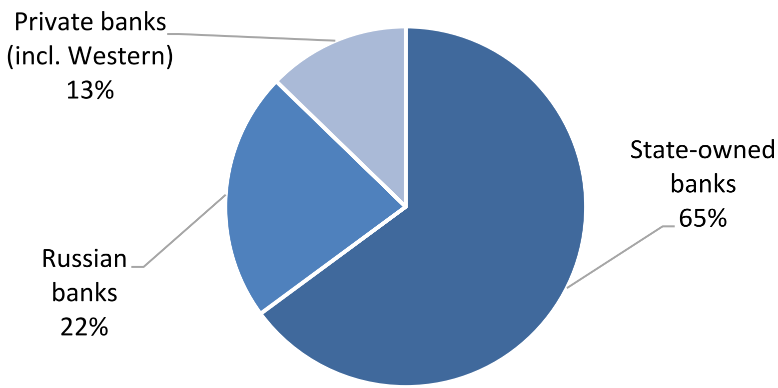
Source: NBRB, own calculations; data as of 01/10/20

- Number of banks remains unchanged since 2016
- 13 banks had a share of assets below 1% (01/10/20)
- Since 17 July, Belgazprombank (owned by Gazprom) is under temporary administration of the NBRB
- Belarusbank (42.4%, state owned) remains market leader and further increased its assets share in 2020
- Largest foreign banks by share of assets are BelVEB (6.2%, Russian owned) and Priorbank (6.2%, owned by Austrian Raiffeisen Holding), followed by Russian owned BPS Sberbank (5.7%)

➢ **Will small banks survive the challenges posed by COVID-19 and recent political turbulences?**

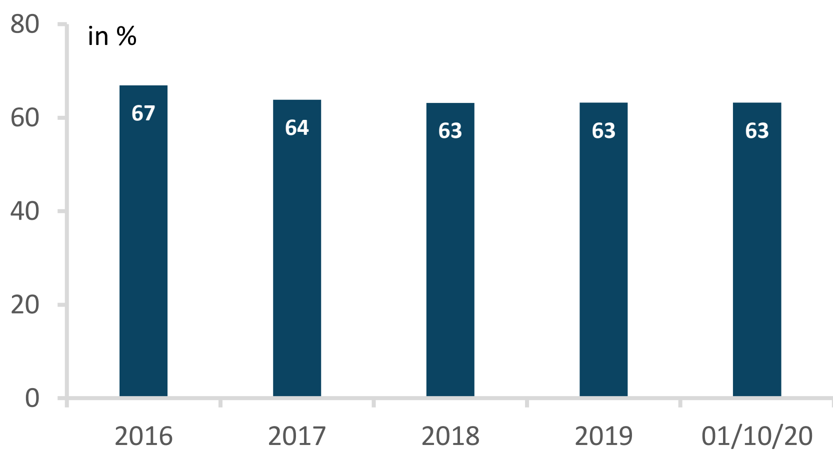
3. Ownership and concentration

Market share by ownership, 01/10/20



Source: NBRB, own calculations; data as of 01/10/20

Share of top 3 banks



Source: NBRB, own calculations; end of period

Share of banks by ownership

- Strong domination of state owned banks (65%), no major change in recent years
- Directly or indirectly state owned Russian banks (BPS-Sberbank, BelVEB, Bank VTB, Belgazprombank) and priv. owned Alfa Bank hold 22% of bank assets
  - Strong position of Russian banks on the Belarusian market
- Private banks (incl. western banks) hold 13% of assets; remains almost unchanged

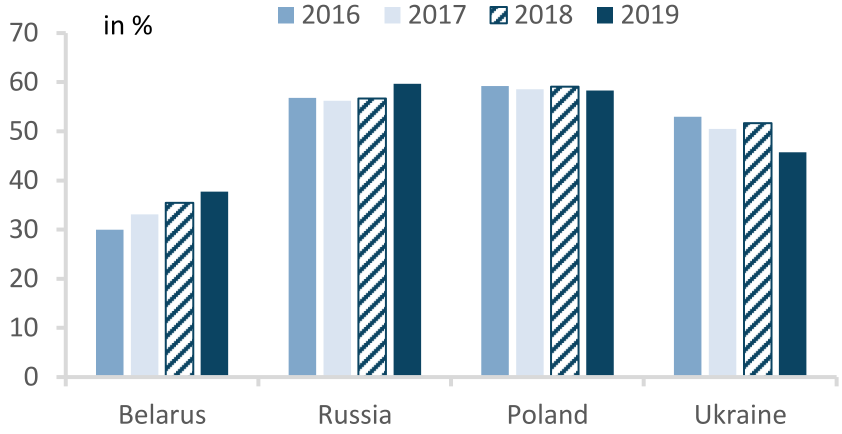
Concentration

- Strong and unchanged concentration of bank assets among top 3 banks (63%); large number of small banks with very little market shares

➢ **Ownership and concentration in bank sector unlikely to change; role of state owned banks might even be strengthened as main liquidity provider to SOEs**

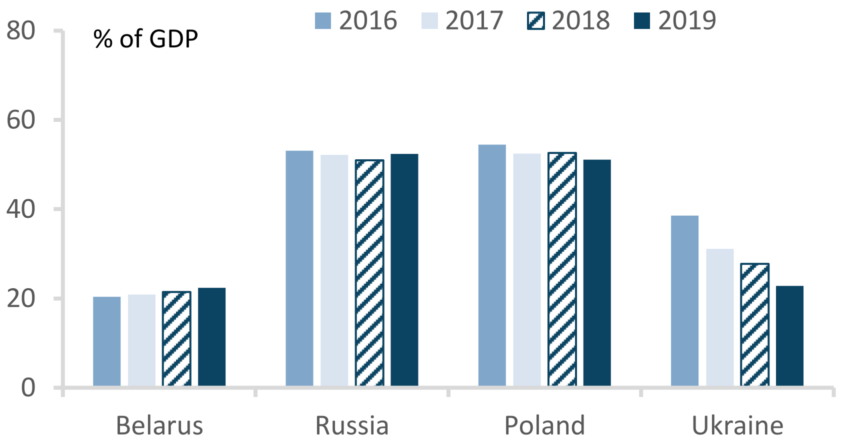
4. Lending to the private sector

Loans to private sector as share of bank assets



Source: National Banks, own calculations; end of period

Loans to private sector to GDP



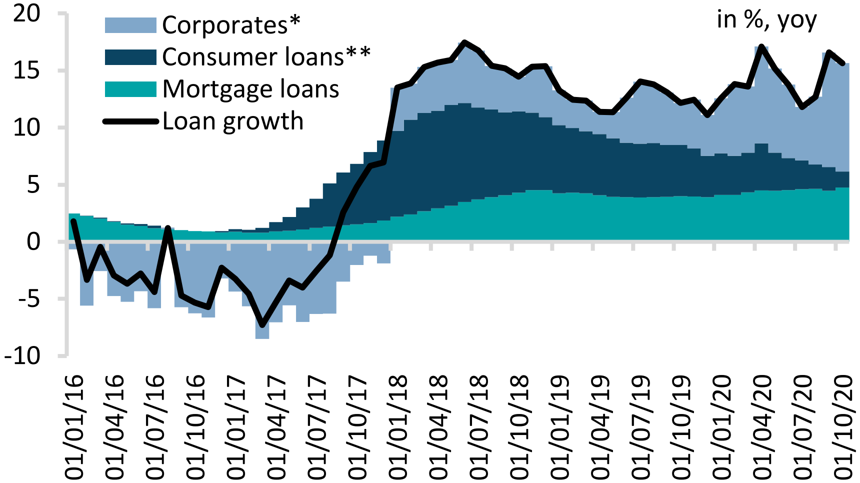
Source: National Banks, own calculations; end of period

- Lending to the private sector increased over the last years, reaching 38% of bank assets in 2019 (up from 32% in 2016); slight increase to 39% in 2020 (01/10/20)
- Share of private sector loans still one of the lowest in the region, showcasing the limited role of (growing) private sector in comparison to Russia, Poland and Ukraine
- However, role of private sector clients probably bigger than lending share suggests (e.g. fee income)
- Increased loan demand and low nominal GDP growth in wake of the COVID-19 crisis may explain the increase of the ratio to 24% of GDP in 2020 (01/10/20)

➢ **Due to COVID-19 and political crisis, lending to private sector could be reduced as banks tend to focus more on SOEs**

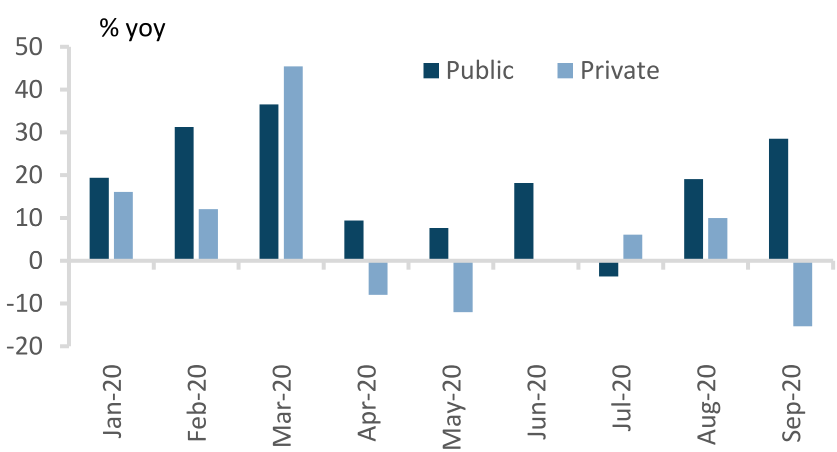
5. Loan growth

Contribution to loan growth (outstanding amounts)



*Source: NBRB, own calculations; *incl. NBFI, **excl. mortgages; constant exchange rates*

Dynamics of new loans by sector



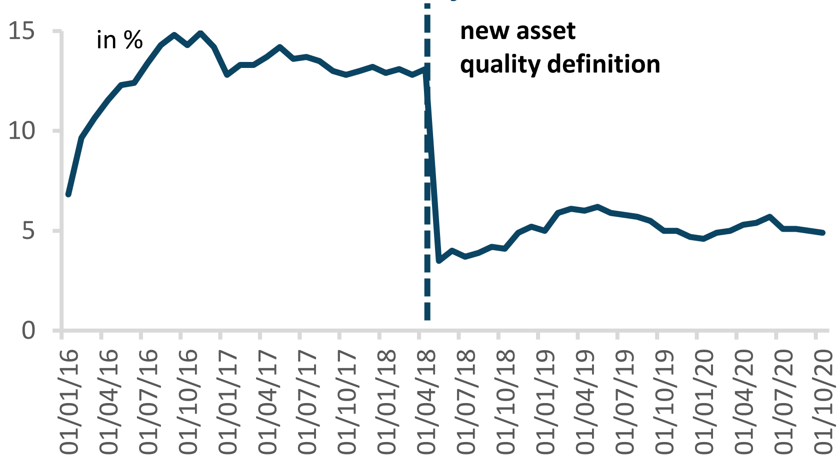
Source: NBRB, own calculations

- Bank lending growth (outstanding amounts) remains positive since late 2017 (01/10/20: +15.6% yoy)
  - Retail credit growth has been the most dynamic (consumer loans and mortgage loans), but slowed down recently
  - Outstanding amounts of corporate lending have picked up significantly in 2020, especially in Mar-20 (COVID-19) and Sep-20 (political crisis)
- However: new lending to the private sector has been weak in the wake of COVID-19 and the political crisis
- Similar, but less pronounced: new loans to the public sector have been less dynamic since Mar-20

➢ **Loan growth might decrease as economic activity weakens and banks tighten liquidity**

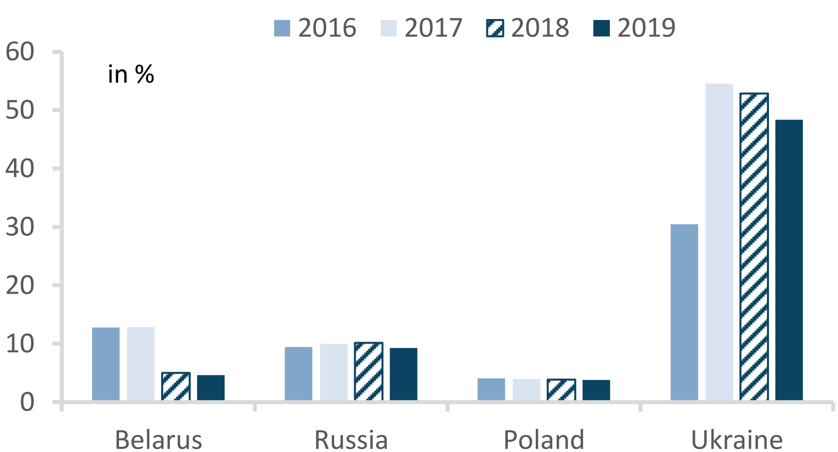
6. Non performing loans (NPL)

NPLs as a share of assets subject to credit risk



Source: NBRB

NPLs to total gross loans



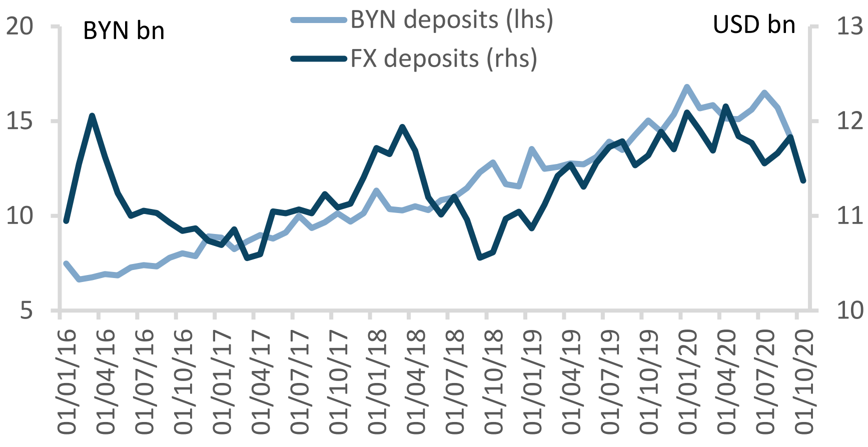
Source: IMF FSI

- Significant increase of NPLs during Q2 and Q3 2020 (Sep-20: +14% yoy) due to COVID-19
- However: NPLs ratio slightly decreased again in Q3 2020
- In regional comparison, NPL ratio lower than in Russia, and in particular Ukraine, almost same level as Poland
- According to rating agencies, asset quality is likely to be considerably weaker than the reported NPL ratio of 5%
- Forbearance measures undertaken by the NBRB during the crisis may also understate the true situation

➢ **NPLs could increase significantly in the short/medium run as a result of COVID-19, the political crisis and deteriorating balance sheets of SOEs**

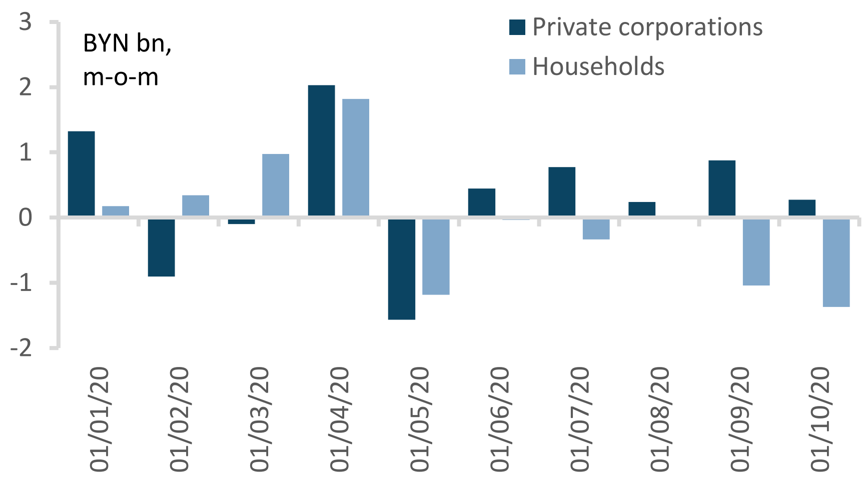
7. Deposits

Bank deposits



Source: NBRB, own calculations

Change in outstanding deposits



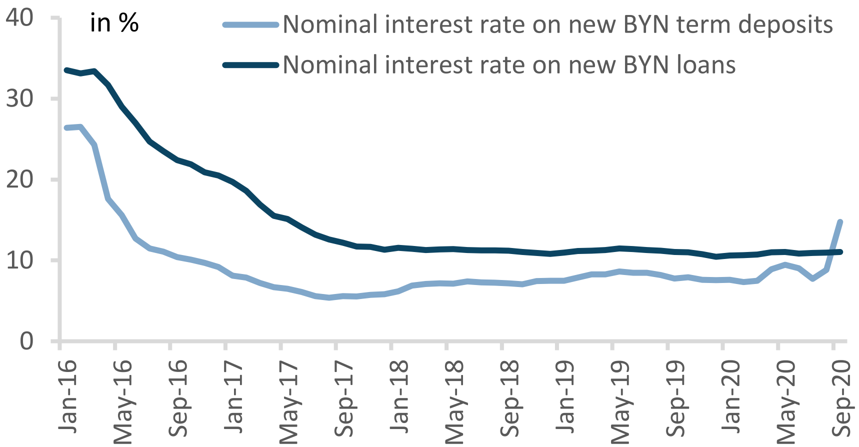
Source: NBRB, own calculations

- Since 2016: steadily growing amount of BYN deposits; FX deposits show more fluctuation, but the amount has not changed significantly over time
- Relevance of irrevocable term deposits is a positive and stabilizing feature
- In the wake of COVID-19: strong household deposit withdrawals since May-20; no return of deposits to banks in the following months
- Moreover: another wave of withdrawals in since Aug-20 due to political crisis
- However, share of term-deposits in outstanding deposits remains high (slightly under 70%)

➢ **Further withdrawals of deposits likely if political instability and COVID-19 crisis continues**

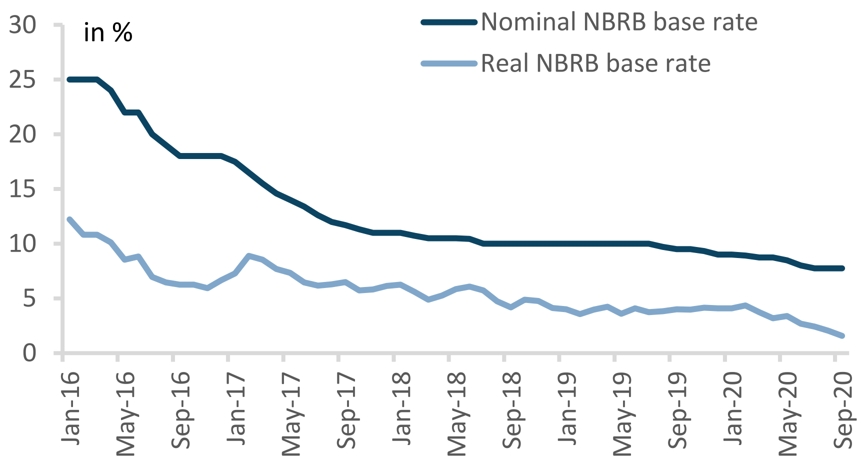
8. Interest rates

Interest rates on loans and deposits



Source: NBRB; monthly averages

NBRB policy rate



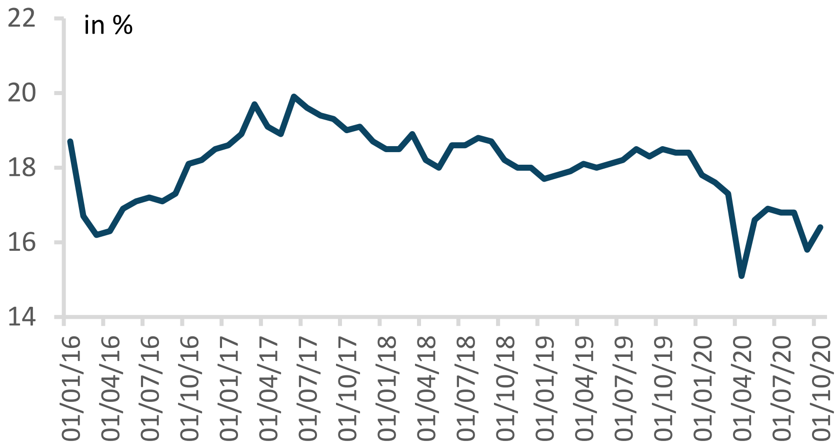
Source: NBRB; monthly averages

- Nominal interest rates have declined considerably since 2016 to currently 9% on new deposits and 11% on new loans in BYN
- Difference between deposits and loans interest rates (net interest margin) stands at ca. 2%; has narrowed over time and is one reason for the decreasing profitability of the banking sector in Belarus
- Policy rate cut to 7.75% on 01.07.2020; remains unchanged since then
- Since Aug-20: spread between nominal interest rate on new loans and term deposits has turned negative as banks try to counteract the deposit outflow
- Administrative caps on lending rates distort the lending process and pose a problem for profitability and capital building

➢ **Pressure on interest rates remains high, which might decrease overall profitability of the banking sector**

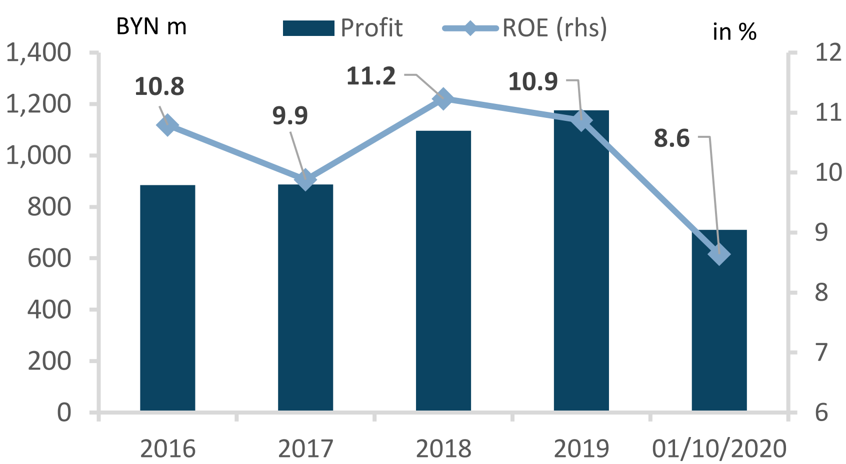
9. Capital adequacy and bank profits

Capital adequacy ratio (CAR)



Source: NBRB

Banking sector performance



Source: NBRB; after taxes, end of period

Capital adequacy ratio (CAR)

- With 16.4%, CAR still on a satisfactory level (01/10/20)
- Since beginning of 2020: decline by 1.4 pp as a result of strong asset growth and no corresponding equity increase; probably also related to FX depreciation
- However, still comfortable capital buffers when facing losses or declining profits

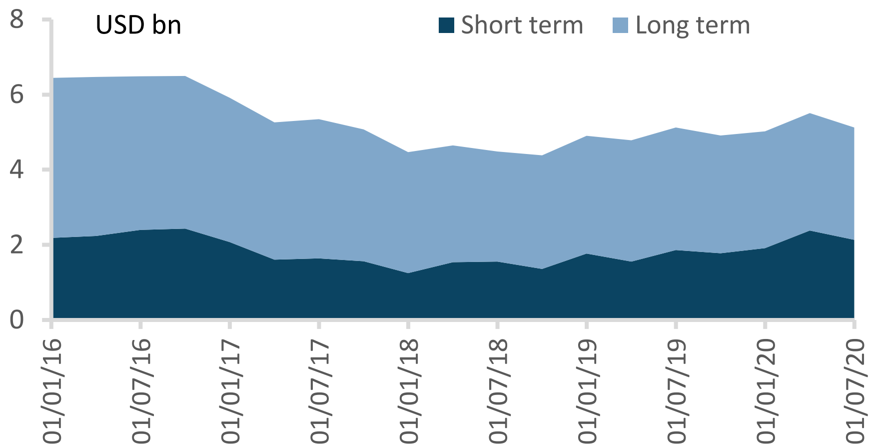
Banking sector profit

- With 10.9% in 2019, sector profitability (ROE) above Poland (8.0%), but significantly below Ukraine (37.6%) and Russia (19.5%)
- 2020: COVID-19 and political turbulences further reduced profitability of banks to 8.6% (01/10/20)

➢ **If political crisis and COVID-19 continues, CAR of banks might deteriorate and eat up capital buffers**

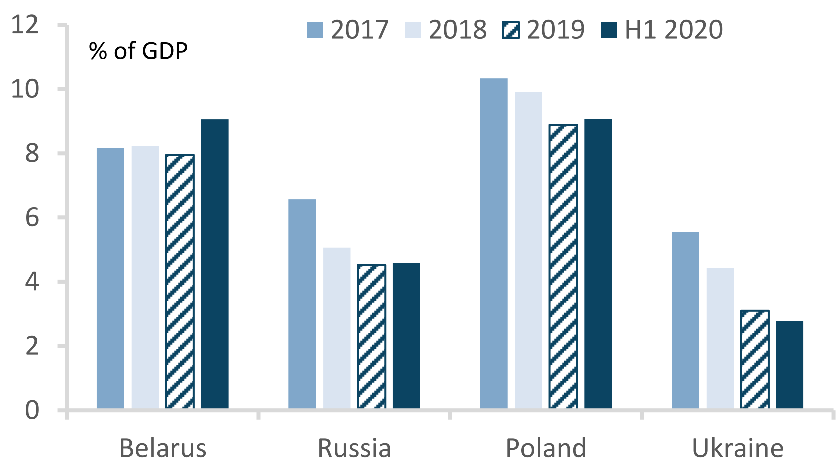
10. External debt

External debt of banking sector



Source: NBRB; end of period

External debt of banking sector to GDP



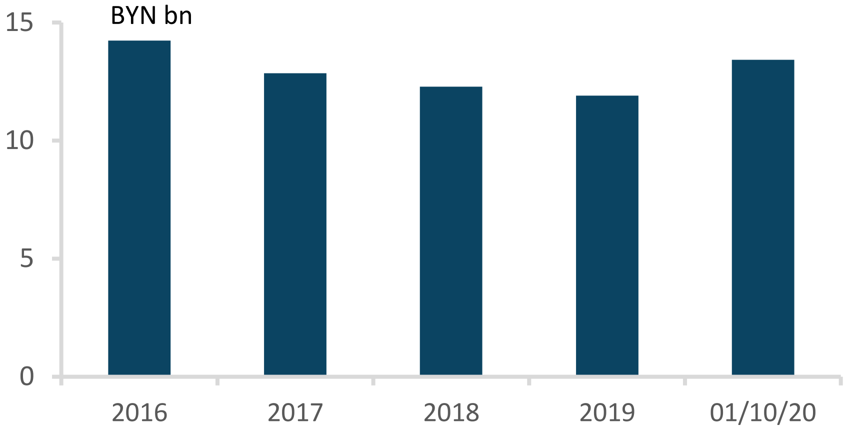
Source: National Banks, own calculations; end of period

- External debt declined since 2016 from USD 6.3 bn to USD 4.5 bn (01/07/20)
- Share of long term debt has come down, as less state guarantees for long term financing are available
- External debt increased in 2020 and equals 9.1% of GDP (01/07/20); this constitutes a source of risk in case of exchange rate volatility and limited market access
- As % of GDP, external debt is lower than in Poland, but higher than in UKR and RUS
- With close to 50% of external liabilities, Russia remains the main funding source
- Nov-20: Fitch changed the outlook for sovereign and several large bank's rating to negative

➢ **Ratings for Belarussian banks will likely remain under pressure, limiting access to financing in foreign currency and making it more expensive**

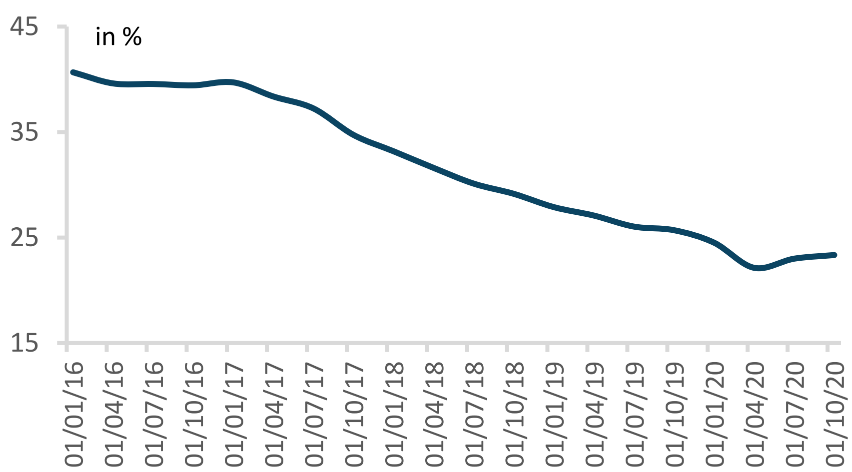
11. Directed lending

Directed lending



Source: NBRB; eop, excl. Development Bank

Share of directed lending in total bank lending



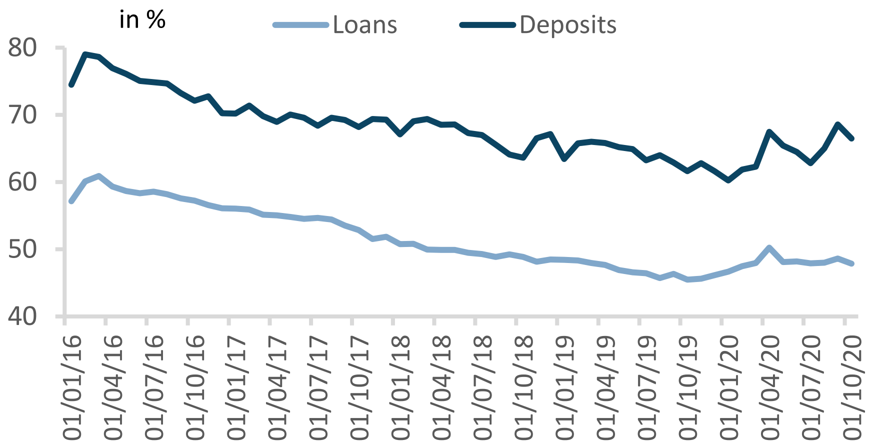
Source: National Banks, own calculations; excl. Development Bank

- Directed lending is a key long-term feature of the banking system in Belarus
- Due to many problems associated with this non-market form of credit allocation, there have been steps undertaken to decrease the share of this type of lending in the commercial banking sector
- This showed some success: the share of directed lending in total lending dropped from more than 40% in 2016 to 22% in Apr-20
- However, since May-20, a turnaround of this positive trend is observable:
  - Directed lending portfolio up in absolute terms
  - Share in total lending has increased

➢ **If COVID-19 and political crisis continue, directed lending might increase, as SOEs have no other access to liquidity. This might increase financial instability**

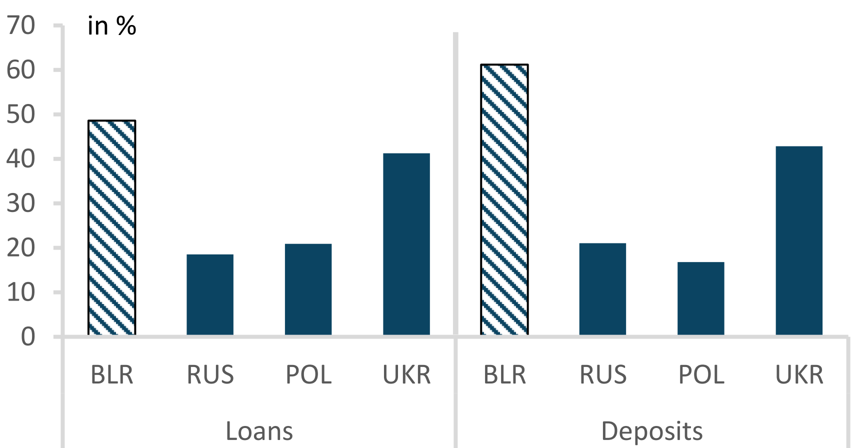
12. Dollarization

Dollarization of loans and deposits



Source: NBRB

Dollarization in international comparison



Source: IMF FSI; data for 2019

- Until the COVID-19 crisis dollarization of deposits and loans on a long-term downward trend at least since mid-2016 from 80% to 60% (deposits) and 60% to 46% (loans)
- NBRB implemented higher reserve rates for FX-deposits and loans to curb dollarization
  - Successful policies
- However, in the wake of the COVID-19 crisis and political uncertainty, a significant increase in already high dollarization in international comparison (01.10.20)
  - Deposits: 66.5%
  - Loans: 47.9%

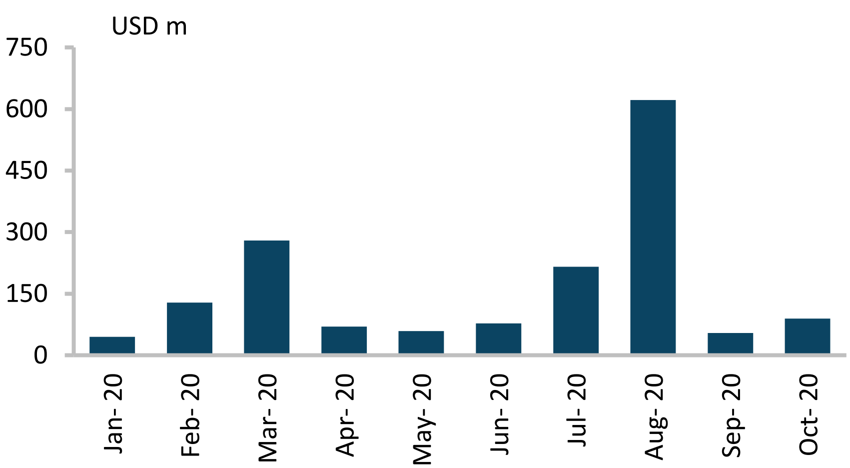
➢ **If current trends continue, dollarization will increase even more, raising financial risks for banks**

13. Current developments (1/2)

Exchange rate

Source: NBRB

Net FX cash demand by physical persons



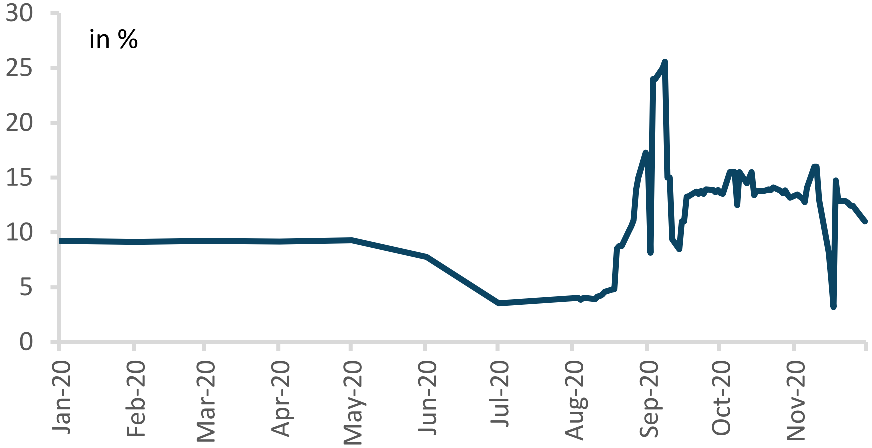
Source: NBRB

- Since beginning of 2020: devaluation of the BYN against the USD of over 20%
  - Fall in oil prices due to the COVID-19 crisis in March/April, followed by domestic political turbulence
  - Some stabilisation at present
- Net demand for foreign currency consistently positive throughout 2020
  - COVID-19 induced increase in Mar-20, then stabilisation
  - Significant increase during the month of elections (Aug-20 vs. Jun-20: +USD 544 m); typical signal of high uncertainty amongst the population

➢ **As the level of dollarization remains high, devaluation poses risks to the banking sector**

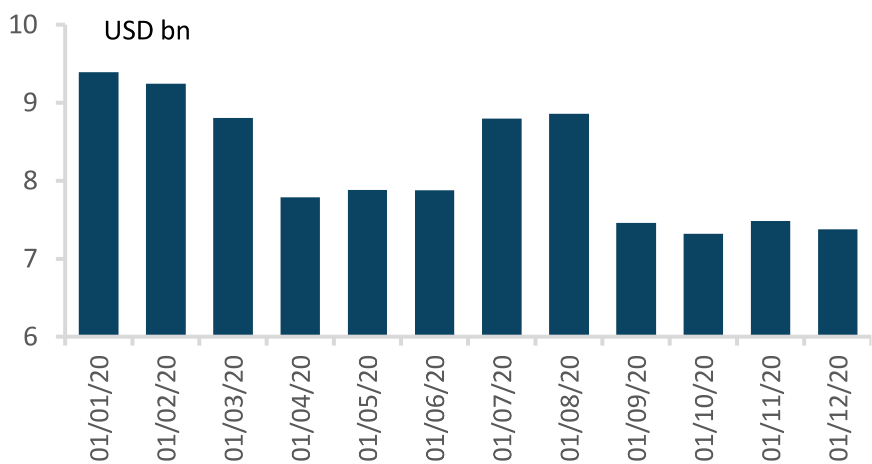
13. Current developments (2/2)

Overnight interbank rate



Source: NBRB; monthly averages; daily data since 03/08/20

International reserves



Source: NBRB

- In order to stabilize the exchange rate, NBRB tightened the liquidity supply
- As a result: overnight interbank rate increased significantly, peaking at over 25% in Sep-20
- Overall, liquidity in the banking sector is tight
- Moreover: Due to FX interventions, international reserves dropped significantly (01.12.2020: USD 7.4 bn)
  - Decline earlier in 2020 due to COVID-19 crisis, followed by a recovery (mostly due to Eurobond issue)
  - Sharp fall of USD 1.4 bn in Sep-20 due to interventions in the foreign exchange market

➢ **Slow stabilisation on the interbank market; FX reserves also stable since several months, but on a low level**

ANNEX. COVID-19: Regulatory measures

Regulatory policy response by the NBRB

- Key policy rate cut from 8.75% to 7.75% (on 01.07.) in several steps
- FX interventions to mitigate depreciation of the BYN
- Easing of a number of prudential requirements (e.g. several indicators tied to credit risk)
- Guidance / recommendation to banks …
  - … to provide credit holidays
  - … to restrain from increasing interest rates on restructured debt
  - … to minimize the margin between FX sales and purchases
  - … to avoid extra charges / fees for banking operations
- Overall guidance to suspend dividend distributions
- Prolongation of maturity of NBRB’s refinancing loans for banks

Annex. Bank sector statistics

Balance sheet data	2016	2017	2018	2019	01.10.2020
Total assets	64,467.0	66,679.6	73,706.4	78,344.5	89,544.3
growth in % yoy	2.3	3.4	10.5	6.3	19.0
in % of GDP	67.9	63.1	60.6	59.4	63.1
Total loans	35851.0	38762.5	44061.0	48551.6	57527.4
growth in % yoy	-5.1	8.1	13.7	10.2	24.4
in % of GDP	38.0	36.7	36.2	36.8	40.5
Loans to private enterprises	11,860.2	12,613.9	13,901.6	14,977.7	18,607.0
growth in % yoy	-10.1	6.4	10.2	7.7	27.6
in % of GDP	12.6	11.9	11.4	11.4	13.1
Loans to households	7155.4	9031.9	11596.4	14152.9	15512.4
growth in % yoy	4.02	26.22	28.39	22.05	18.67
in % of GDP	7.6	8.5	9.5	10.7	10.9
Loans in foreign currency	20,089.1	19,684.8	21,337.8	22,595.0	27,543.6
growth in % yoy	-7.0	-2.0	8.4	5.9	28.8
in % of GDP	21.30	18.61	17.55	17.12	19.39
Loans in foreign currency (% of total loans)	56.0	50.8	48.4	46.5	47.9
Total deposits	29,946.0	32,987.8	35,176.3	42,302.8	44,188.7
growth in % yoy	1.4	10.2	6.6	20.3	14.9
in % of GDP	31.8	31.2	28.9	32.1	31.1
Deposits from households	19074.2	20103.1	22173.9	24019.0	23196.5
growth in % yoy	-1.03	5.39	10.30	8.32	0.52
in % of GDP	20.2	19.0	18.2	18.2	16.3
Total loans (% of total deposits)	119.7	117.5	125.3	114.8	130.2
Structural information					
Number of banks	24	24	24	24	24
Market share of state-owned banks (% of total assets)	66.7	64.5	64.1	63.0	64.9
Market share of foreign-owned banks (% of total assets)	30.8	32.4	32.9	37.0	35.1
Profitability and efficiency					
Return on Assets, after taxes (RoA)	1.6	1.8	2.0	1.9	1.6
Return on Equity, after taxes (RoE)	10.8	9.9	11.2	10.9	8.6
Capital adequacy (% of risk weighted assets)	18.6	18.5	17.7	17.8	16.4
NPLs (% of assets subject to credit risk)	12.8	12.9	5.0*	4.6*	4.9*

*Source: NBRB monthly bulletin, Belstat, own calculations; end of period, Note: *new methodology*

About the German Economic Team

The German Economic Team (GET) advises the governments of Ukraine, Belarus, Moldova, Georgia and Uzbekistan regarding the design of economic policy reform processes and a sustainable development of the economic framework. As part of the project we also work in other countries on selected topics.

In a continuous dialogue with high-level decision makers of the project countries, we identify current problems in economic policy and then provide concrete policy recommendations based on independent analysis.

In addition, GET supports German institutions in the political, administrative and business sectors with its know-how and detailed knowledge of the region's economies.

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