NEWSLETTER

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Belarusian ruble hit by the depreciation of the Russian ruble

The Russian ruble's rapid decline in value due to the collapse in oil prices and the Western sanctions in the last quarter of 2014 has raised the question of what the effects on Belarus might be, as the country's economy and finances are heavily dependent on Russia.

Against this backdrop, it is not surprising that the pressure to devalue the Belarusian ruble became much stronger in December 2014, as reflected in major losses in foreign exchange reserves. Thus, after some hesitation, the country's National Bank was forced to devalue the currency considerably and raise interest rates. At the same time, the switch to a basket of currencies was announced in order to dissolve the relatively tight peg to the US dollar, although no further details are yet known.

Whether this course of action will stabilise the situation in the long term remains to be seen and will ultimately depend on further developments in Russia. The decision-makers in Belarus must now address the effects of the devaluation on other areas of the economy, such as an expected rise in inflation.

Depreciation of the Russian ruble

For the past year or so, the CIS region has found itself in an increasingly adverse economic environment. Whereas the difficult financial and economic situation in the Ukraine has been apparent for some time, the situation in Russia has worsened, especially after the Western sanctions were imposed. Another negative factor was the dramatic collapse in oil prices, especially in the last quarter of 2014.

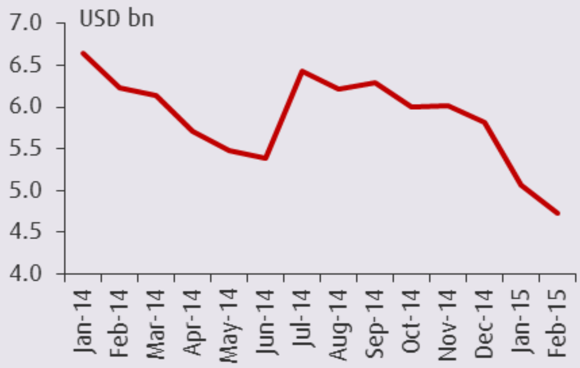
These effects as a whole have put massive pressure on the Russian ruble in particular. Unlike the global financial crisis in 2008/2009, during which the Russian Central Bank absorbed at least some of this pressure with months of exchange rate interventions resulting in the loss of more than USD 200 bn in reserves, there was much less intervention at the end of 2014 and the resources could thereby be preserved.

The sharp decline in the Russian ruble towards the end of the year raised questions about the development of the Belarusian ruble in particular, as both countries have close economic and financial ties.

Response by the National Bank

In December 2014, the National Bank of Belarus faced increasing pressure to devalue; as the following graph shows, it lost almost USD 800 m in currency reserves in that month alone.

International currency reserves



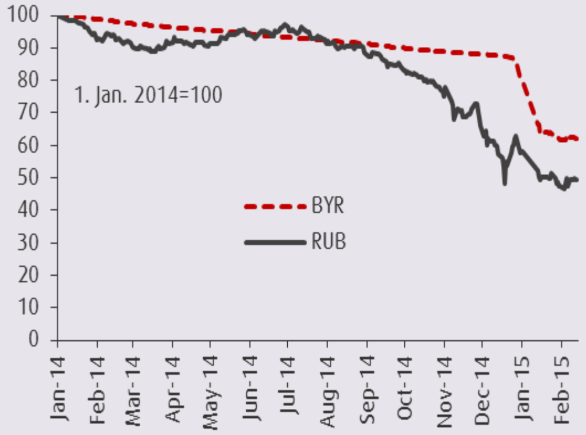
Source: National Bank of Belarus, IMF methodology

In response to this situation, a decision was made to change the exchange rate policy, which consisted of permitting an even, relatively low devaluation against the US dollar. Over the course of 2014, this figure stood at around 14%.

On 19 December, the National Bank agreed an initial package of measures, with the aim of stabilising the situation on the financial markets. Certain central bank interest rates were hiked up to 50% to make the domestic currency more attractive again. It was also made mandatory for 50% of export revenues to be sold on the foreign exchange market. The decision to introduce a temporary tax of 30% on the purchase of foreign currency by households and companies was met with criticism. It was hoped that this measure would curb the tangible rise in demand for foreign currency without having to change the official exchange rate.

The tax rate of 30% had already been cut to 20% on 30 December, and the official exchange rate was devalued at the same time. The tax rate was down to just 10% on 5 January 2015, before being abolished completely on 8 January. Thus, the realisation was made fairly quickly that there is no alternative to a clear and fast devaluation and that corresponding delay tactics only lead to complications and uncertainty rather than addressing the underlying problem. As a result, the Belarusian ruble fell sharply, as shown in the graph below.

Exchange rate BYR and RUB against USD, indexed



Source: Belarus National Bank, Central Bank of Russia

Assessment of the National Bank's policy

On a positive note, after some initial hesitation the realisation was made that there is no alternative to adjusting the exchange rate. Reference is made here to 2011, when a similar situation led to attempts to hide this fact with months of administrative measures. This came at a huge cost to the economy and, ultimately, did not constitute an alternative to a massive adjustment.

It is still too early to say with certainty whether the current devaluation will be enough to stabilise the external situation of the country and compensate for the loss in competitiveness. Foreign reserves dropped again in January 2015, albeit less drastically, at around USD 300 m.

A further challenge for the National Bank is the establishment of a new monetary and exchange rate policy framework after the devaluation. In January, the National Bank announced that the currency would be pegged to a basket of currencies consisting of the Russian ruble (40%), the US dollar (30%) and the euro (30%). On the one hand, this should help stabilise expectations in what continues to be a heavily dollarised economy; on the other hand, pegging the currency to a basket provides a certain degree of flexibility in relation to the individual basket currencies. However, it should be noted that the specific details of this peg, such as the permitted fluctuation margin, are not yet known. It is important not to forget that a similar basket of currencies was introduced at the start of the global financial crisis in 2009, but quickly became nothing more than a US dollar peg again, i.e. it did not have the desired effect of sustained flexibility.

Conclusion

Belarus is currently suffering the disadvantages of a very one-sided economic and financial interdependence with Russia. The contagious effects of the depreciation in Russia at the end of last year have also been felt in Belarus, making a sharp devaluation unavoidable. After some initial hesitation, the decision-makers became aware of this and took appropriate action.

The decision-makers in Belarus will now have to address the different implications of this devaluation. One problem concerns inflation, which, at double figures, was already very high before the devaluation and is expected to increase even further. This has already resulted in administrative price freezes and similar measures being taken again, which, instead of helping, only create more problems and are therefore highly inadvisable.

Another problem is that the government faces considerable interest and principle payments on foreign currency liabilities this year. It must raise a total of USD 4.1 bn (well over 5% of its GDP) to repay loans and bonds. The considerably weaker exchange rate also presents a certain challenge in this respect, as it increases the debt service in terms of the local currency.

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