Banking Sector Monitoring Belarus

- Trends and Selected Issues -

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Summary

- **Bank assets** (67% of GDP/2016) are growing due to impact of depreciation, thereby closing the gap to regional leaders Poland and Russia and overtaking Ukraine
- However, **credit to the private sector** (enterprises and households) is stagnating at a low level of 22% of GDP; furthermore, its share in banks' balance sheets is shrinking
- The overall **loan book** is now finally growing yoy on a **nominal** basis (+2.7%), but still shrinking in **real** terms (-1.8%)
- **Deposits** are growing steadily in local currency, and also in foreign currency, albeit in a more volatile nature
- In line with decreasing inflation, **interest rates** are declining steadily (12.2% in local currency)
- Directed lending is still being practiced, but gradually reduced in the commercial banking sector (currently 33.4% of loan stock vs. 39.5% in 2016)
- The issue of **problematic assets** (12.8% of assets subject to credit risk) still deserves close attention; transfers of certain non-performing loans (NPLs) in agriculture to the newly founded **"Asset Management Agency"** provided some relief to the banks, but did not address the problem in a comprehensive manner
- NPLs have implications for the **capital** position, **profits** and also **new lending** of banks

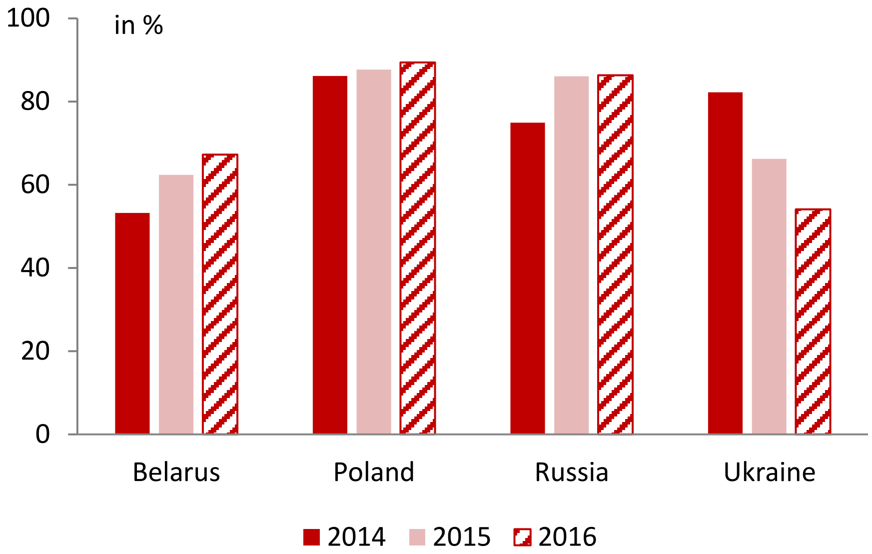
Content

Key indicators:

Selected issues:

1. Bank assets in a regional context

Bank assets to GDP

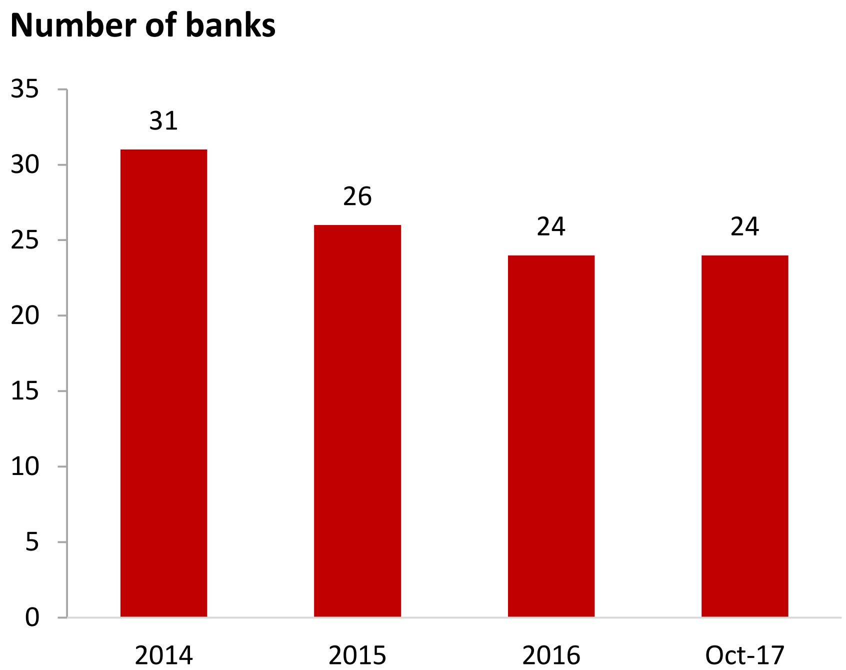


Source: Own calculations based on IMF data, Note: 2016 data for Russia is an estimate as data are reported only until Oct 2016
Note: Bank assets are gross assets net of provisions

- The size of the banking sector in Belarus in 2014 was smaller than in neighbouring Russia, Poland and Ukraine if measured by bank assets to GDP
- Over 2014-2016, the sector increased relative to GDP due to depreciation in the presence of significant FX assets
- At the end of 2016, Belarus (67%) was placed behind the regional leaders Poland (89%) and Russia (86%), but ahead of Ukraine (54%, down from 82% in 2014), which faced severe banking sector problems during that period

⇒ Belarus narrowed the gap to regional leaders Poland and Russia in banking penetration

2. Number of banks



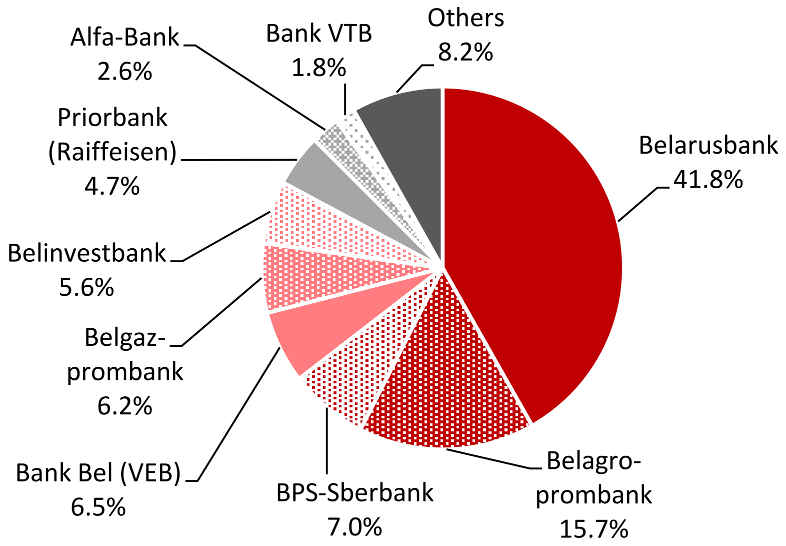
Source: NBB; excluding the Development Bank

- In 2014, the number of operating banks amounted to 31
- This number dropped until 2016 to currently 24, as licenses were withdrawn
  - Delta BANK (2015)
  - InterPayBank (2015)
  - Eurobank (2015)
  - Bank of Investment Technologies (2015)
  - North European Bank (2016)
- All above mentioned banks were very small (less than 1% asset share)
- One bank was reorganized into a non-bank entity and another one was merged

⇒ The number of operating banks reduced by almost a quarter over the last years, as some banks were put under liquidation

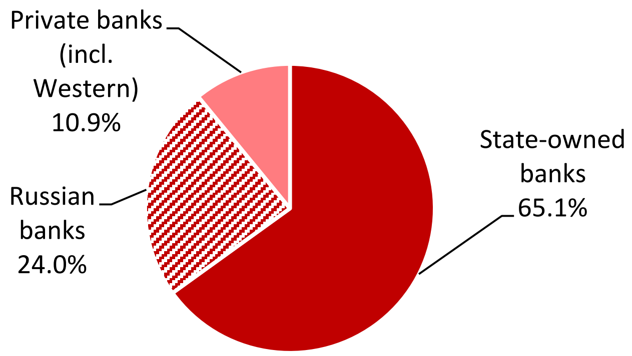
3. Market shares

Banking sector assets



Source: NBB, own calculations, data as of 1 October 2017

Market share by ownership



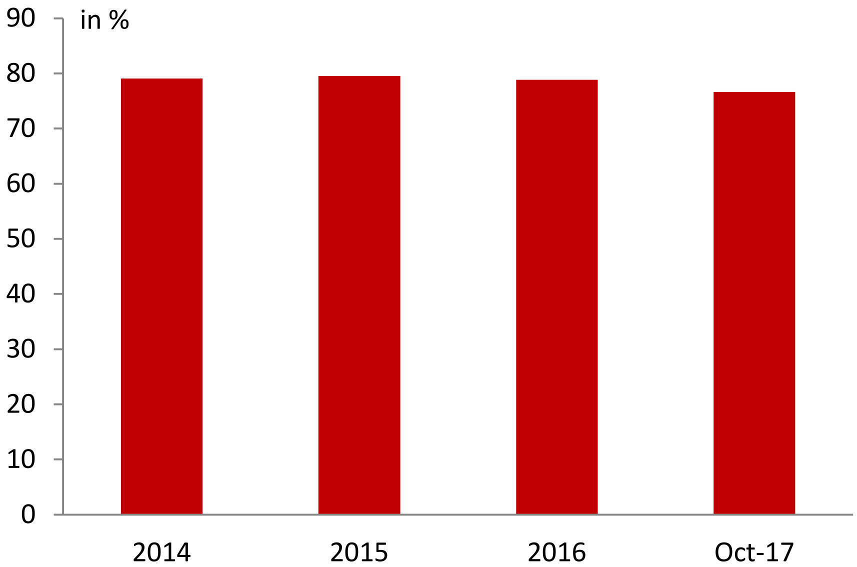
Source: NBB, own calculations, data as of 1 October 2017

- The two largest banks are state-owned: Belarusbank, with 42% market share, followed by Belagroprombank (16%)
- Russian-owned BPS-Sberbank is the largest foreign bank with 7% of market share on the third position
- State-owned banks dominate the sector in terms of market share (65%), followed by banks with Russian capital (24%) and private banks (11%). In the latter group, also banks with non-Russian foreign capital are included
- The biggest EU-owned bank is Priorbank (Raiffeisen from Austria) with 5% market share (rank 7)

⇒ State-owned banks dominate with almost two-thirds of market share

4. Concentration

Share of Top-5 banks



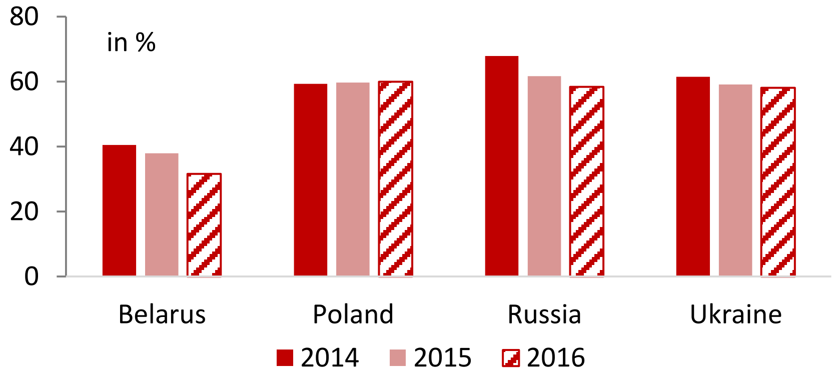
Source: NBB, own calculations based on total assets

- The three largest state-owned banks (Belarusbank, Belagroprombank, Belinvestbank) and two banks with Russian capital (BPS-Sberbank, BelVEB) have been among the Top-5 banks over the last four years
- The aggregated market share of these 5 banks was quite high at 80% in 2015, but decreased gradually to 77% in October 2017
  - Exchange rate effects as well as the transfer of non-performing loans to the Asset Management Agency are to mention here

⇒ High, but slightly decreasing concentration

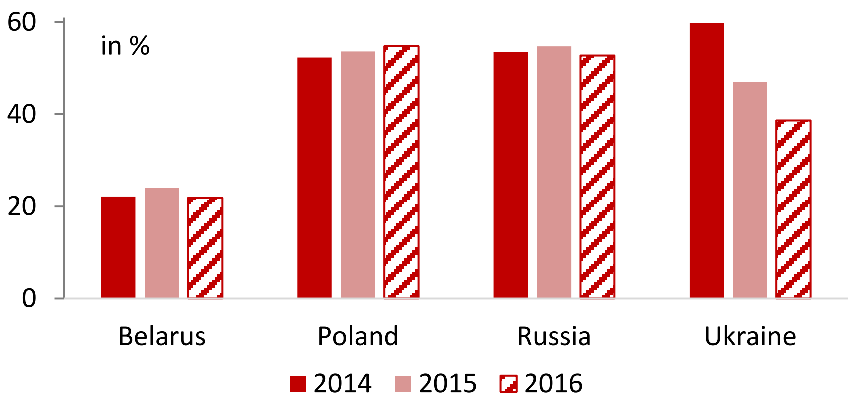
5. Lending to the real sector

Ratio of credit to private sector to bank assets



Source: Own calculation based on IMF data (IFS for credit to private sector and FSI for bank assets)

Ratio of credit to private sector to GDP



Source: Own calculation based on IMF data (WEO for GDP, IFS for credit to private sector and FSI for bank assets)

Private credit to bank assets ratio

- In Belarus, the share of credit to private sector (predominantly loans) in relation to the whole balance sheet is rather low in comparison
  - 32% compared to 58-60% in peer countries
- Also, this ratio decreased over time
  - From 40% to 32% during the period

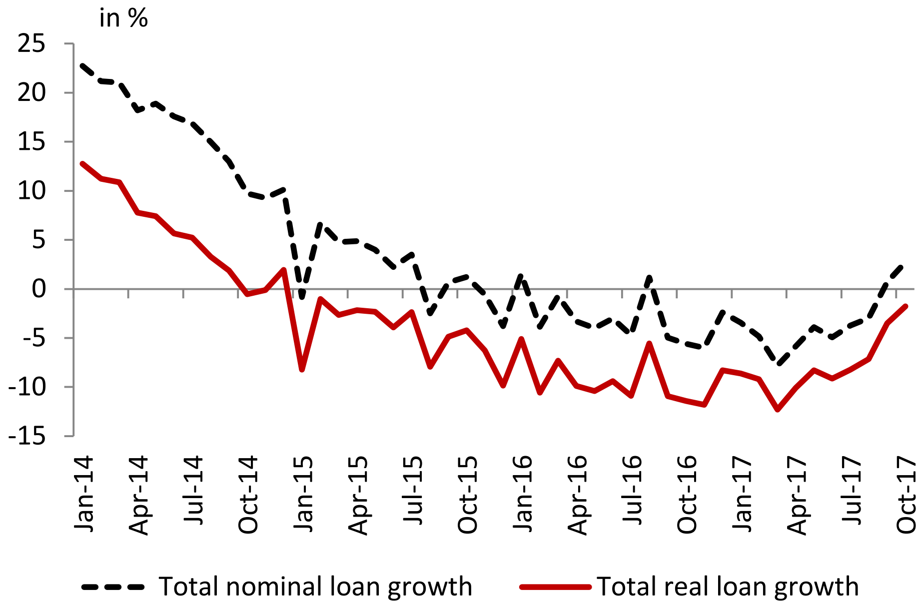
Private credit to GDP ratio

- Also in relation to GDP, the loans to private companies and households are rather low in comparison to the peer group, and stagnating over time

⇒ Lending to the private sector is underdeveloped, mirroring the economic model

6. Loan growth

Loan growth



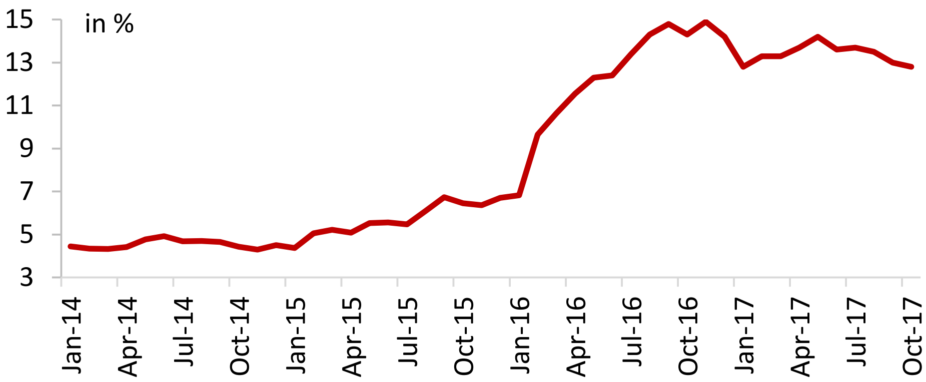
Source: NBB, Note: FX adjusted

- In early 2014, (corporate and household) loan growth was at 22% yoy in nominal terms; it gradually decreased and became negative since summer 2015
- Gradual recovery into positive territory followed (currently at 2.7% yoy)
- Similar developments in real terms, but still negative
- Reflection of both supply and demand-side factors

⇒ Loan growth declined significantly both in nominal and in real terms over the last years; a gradual recovery of the loan book is currently underway

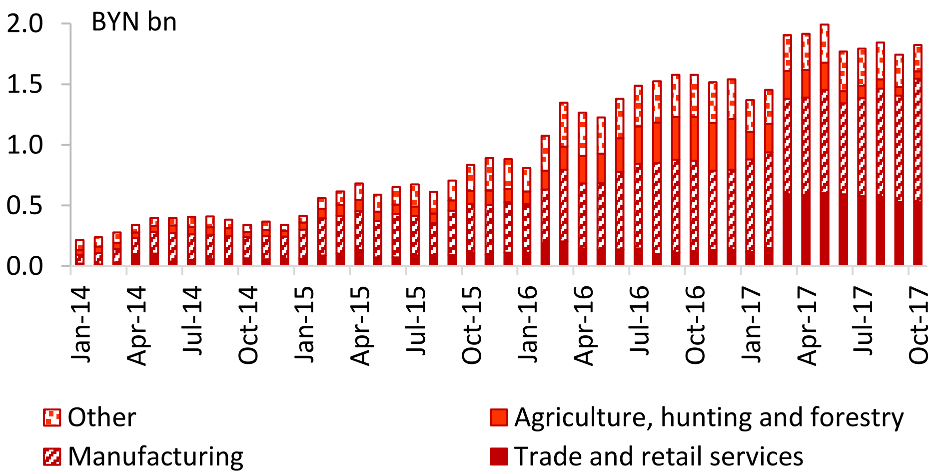
7. Non-performing loans (NPLs)

Problem assets as a share of assets subject to credit risk



Source: NBB

Overdue and extended loans by economic activity



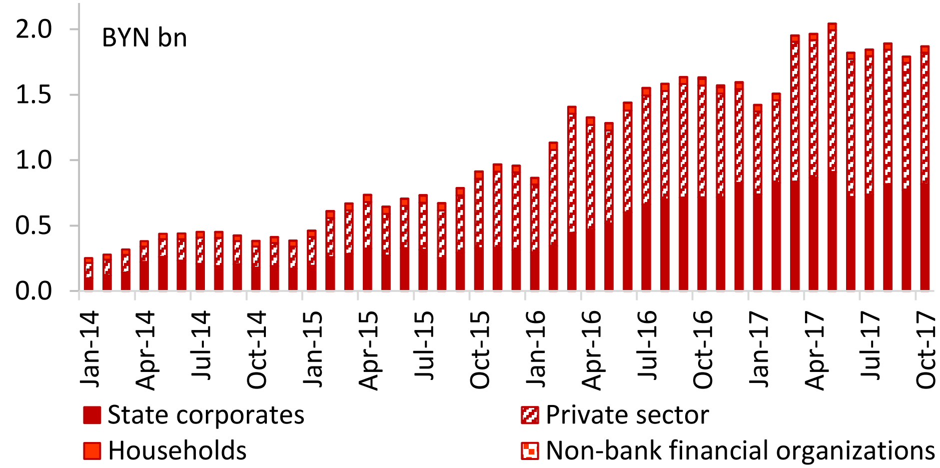
Source: Own calculations based on NBB data

- After some years with a rather low level of problem assets, there was a sharp increase in such assets (risk categories III-V) since early 2016 due to adverse economic dynamics and the unstable financial position of many (mostly state-owned) companies
- At the end of 2016, this trend peaked, and stabilized thereafter at a lower level
  - Transfer of (agricultural) NPLs to new Asset Management Agency (AMA) the main factor for the decline
  - Currently at 12.8%
- Manufacturing enterprises are the most troubled borrowers; also trade companies increased their bad debts

⇒ Worsening of asset quality key trend to observe

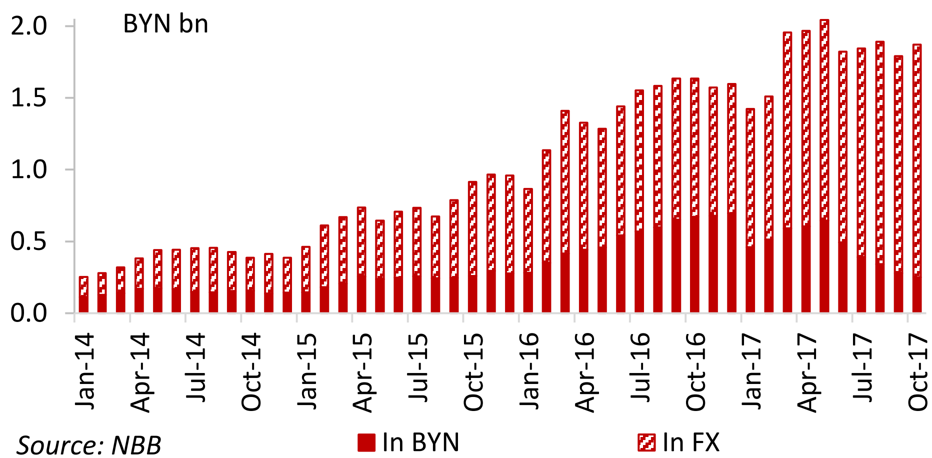
7. Non-performing loans (NPLs) (cont‘d)

Overdue and extended loans by sectors



Source: NBB

Overdue and extended loans by currencies



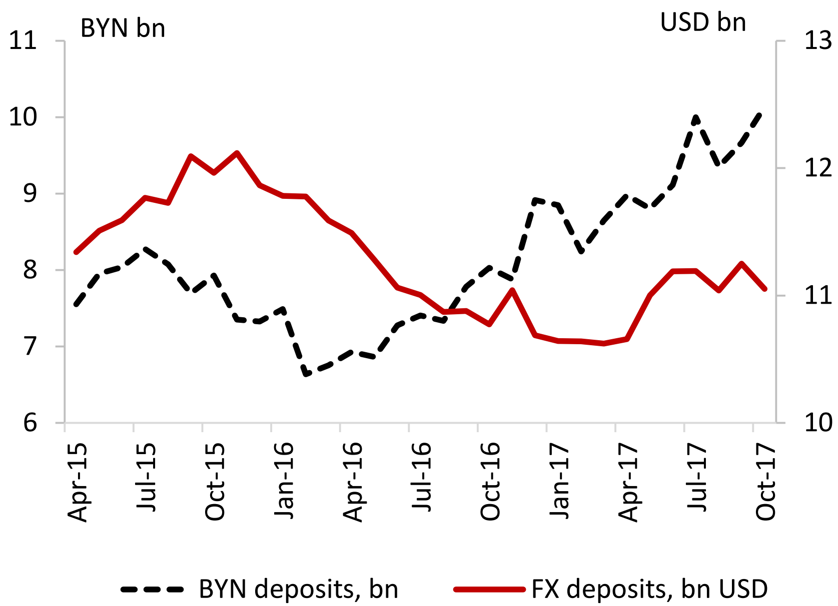
Source: NBB

- In terms of economic sectoral breakdown, till January 2015 state enterprises were the most troubled borrowers; but devaluation of the national currency, high share of loans in foreign currency and absence of state support contributed to a gradual shift towards private companies
  - NPLs on household debt do not play a significant role
- Currently, almost 89% of problem loans are denominated in foreign currency, a ratio that steadily increased over 2017

⇒ NPLs are predominantly in FX and increasingly more often from private companies

8. Deposits

Bank deposits



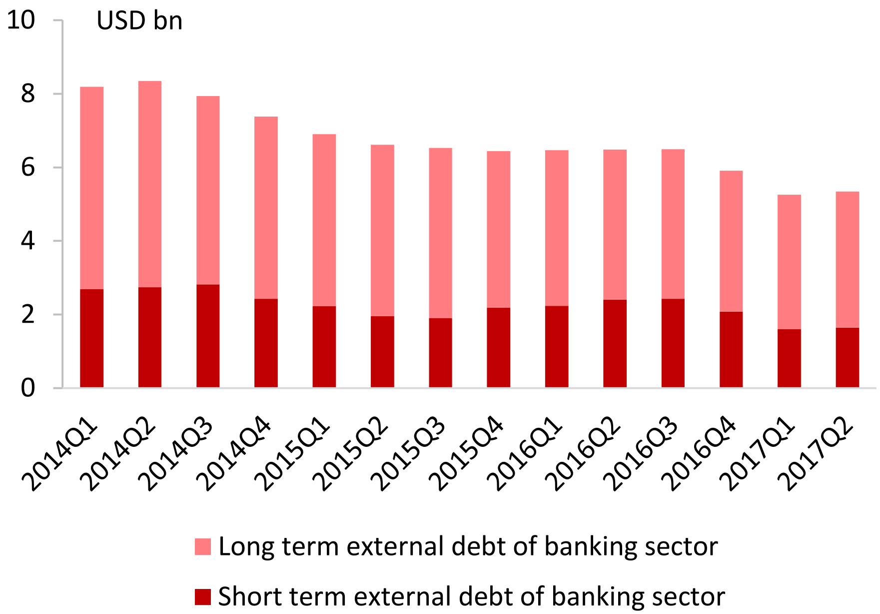
Source: NBB, own calculations

- After increasing until end-2015, FX deposits started to fall and decreased by USD 1.3 bn until early 2017
- This was caused by a drop in real (and nominal) household income, lower returns on FX deposits and a decline in the US dollar
- In 2Q 2017, FX deposits resumed a volatile growth due to corporate deposits
- Deposits in national currency also fell during 2H2015, but started to rise thereafter on a steady pace

⇒ Since early 2016, deposits in national currency are on a steadily rising trend; FX deposits bottomed out about a year later and exhibit a volatile growth pattern

9. External debt

External debt of the banking sector



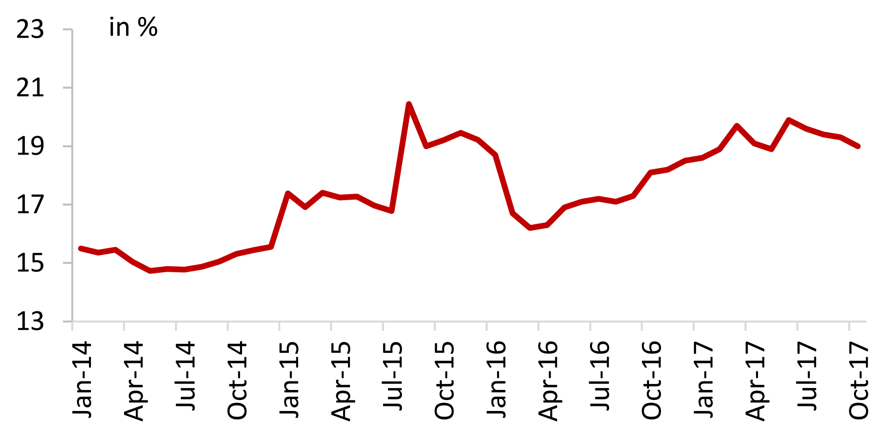
Source: NBB

- External debt of the banking sector peaked at USD 8.4 bn in Q2 2014
- Significant part of that debt was long-term (USD 5.6 bn), while short-term external debt amounted to USD 2.7 bn (at original maturities)
- Since then, a process of gradual deleveraging took place, which brought the debt stock down to USD 5.3 bn in Q2 2017 (a decline by 36%)
- Reflection of high FX liquidity in the banking system, which does not favour new external borrowings; available funds are rather used to pay back external debt

⇒ Longer term trend of external deleveraging continues

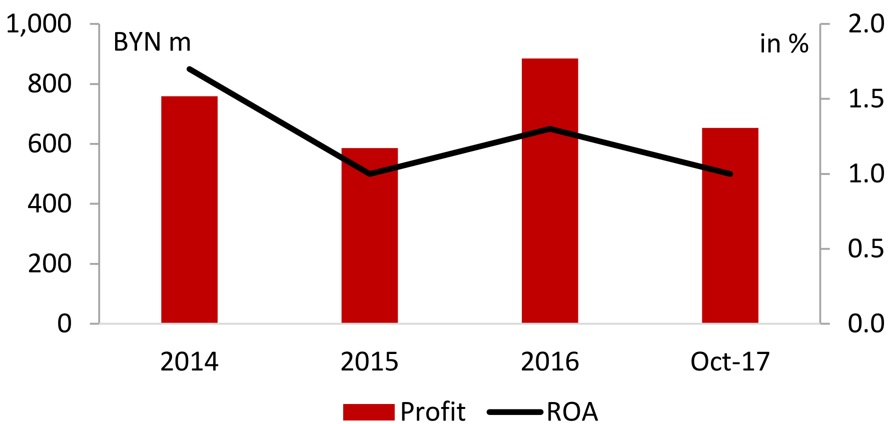
10. Capital

Capital adequacy ratio



Source: NBB

Banking sector profit



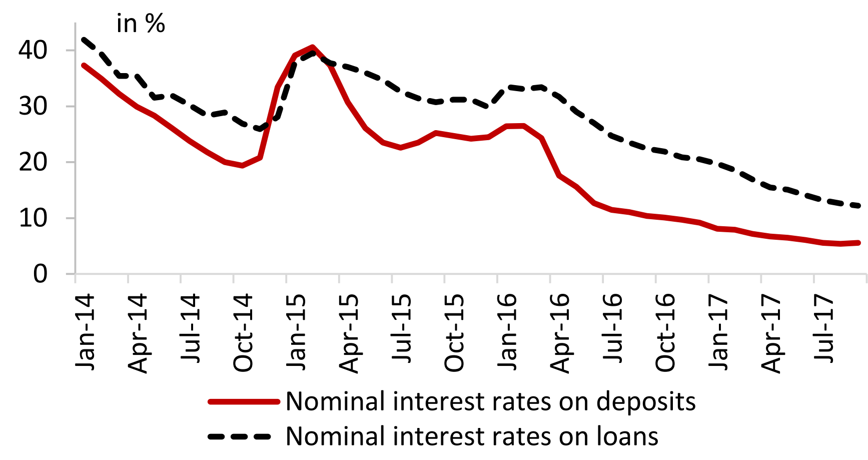
Source: NBB

- The system-wide capital adequacy ratio (CAR) is currently at 19.0% (according to NBB norms) and remains comfortably above the regulatory minimum (10.0%)
- However, an asset-quality-review performed in mid-2016 revealed that in a stress-scenario, CAR would drop to 10.8%; the main reason are the problem loans in the corporate sector
- Due to the sharp increase of NPLs, aggregate banks' profits and their return on assets declined in 2015, but recovered to some extent in 2016, which was also due to the NPL-transfer to the Asset Management Agency (AMA)

⇒ Certain pressure to boost CAR at individual institutions

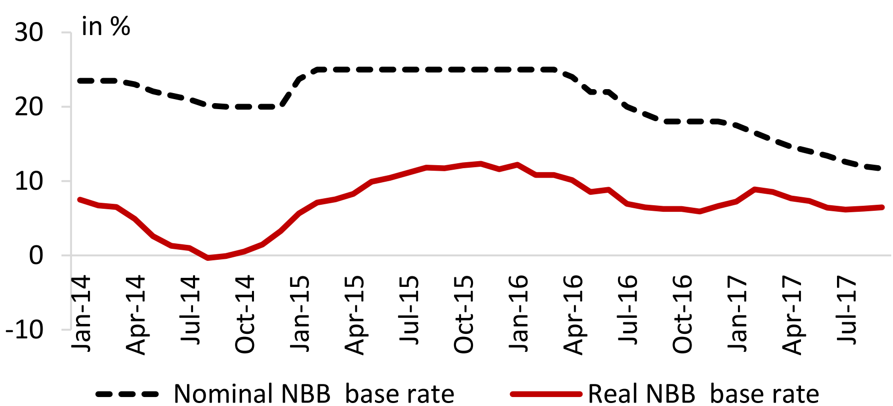
11. Interest rates

Interest rates on BYN loans and deposits



Source: NBB; corporate and household loans and deposits

NBB base rate



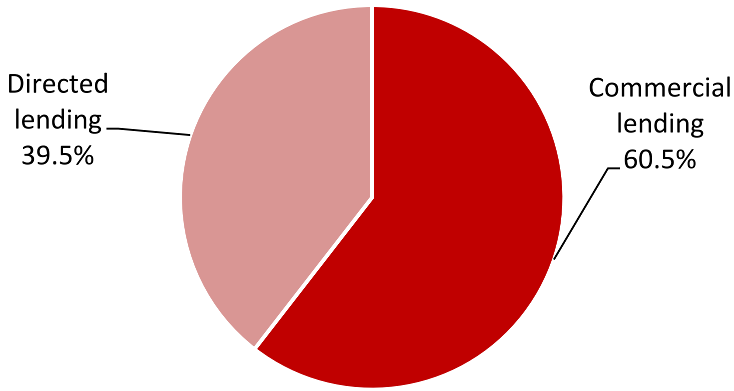
Source: NBB, own calculations based on NBB data

- During 2015-2017, interest rates on BYN loans decreased from 39% to 12%
- A negative interest margin existed in national currency in certain time periods during 2014/2015
  - Mainly driven by the need to increase deposit rates during periods of stress
- The National Bank reduced policy rates during 2013-2014, but had to hike in early 2015, when pressure on the BYN was building up
- In line with falling inflation (4.9% yoy currently), it resumed its rate-cutting cycle in 2016-2017
  - Base rate at 11.7% (Sep)
- Policy rates are in real terms positive

⇒ **Quickly declining policy and loan interest rates**

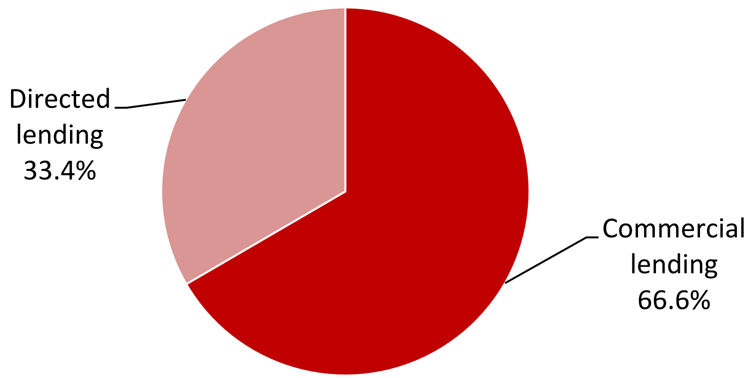
12. Directed Lending

Structure of bank loans as of 1 January 2016



Source: NBB; excluding Development Bank

Structure of bank loans as of 1 October 2017



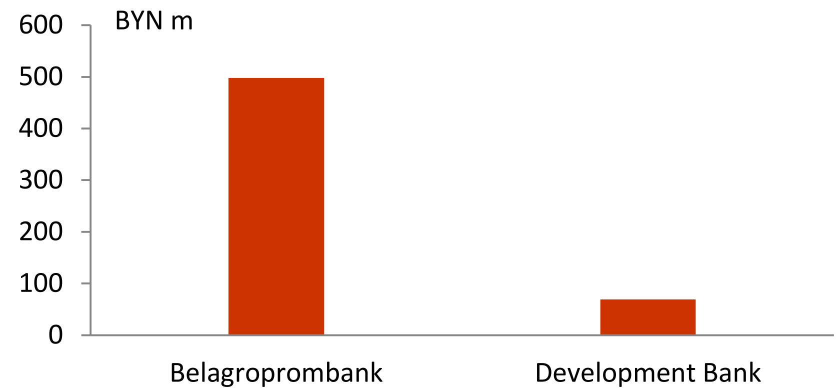
Source: NBB; excluding Development Bank

- Directed lending by the government is a key channel of state influence on Belarus’ economy
  - Key beneficiaries are industry, agriculture and housing
- This type of lending distorts the financial system as well as the real sector
  - In 2015, interest rates on such (local currency) loans amounted to 9%, while the non-subsidized borrowers paid 34% on average
- The respective share of the loan book is declining over time, which is a very positive development
  - From 39.5% in early 2016 to 33.4% currently

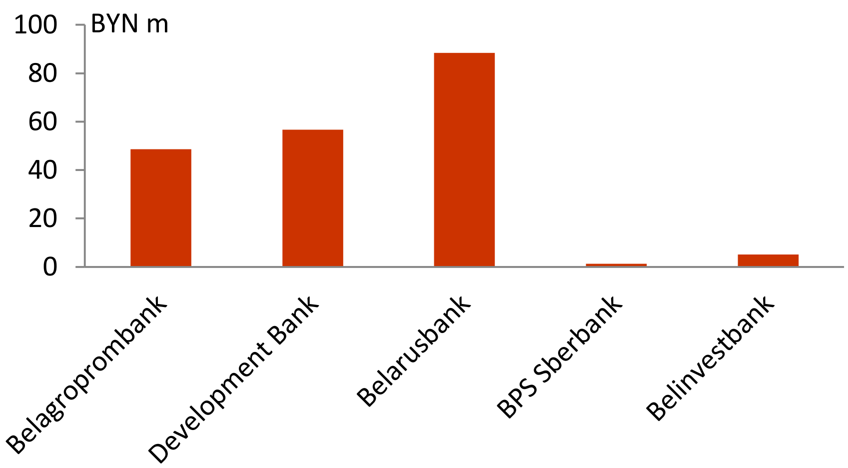
⇒ Further reducing directed lending is an important step towards a more market-based model

13. Asset Management Agency

First transfer (01.11.2016)



Second transfer (01.05.2017)



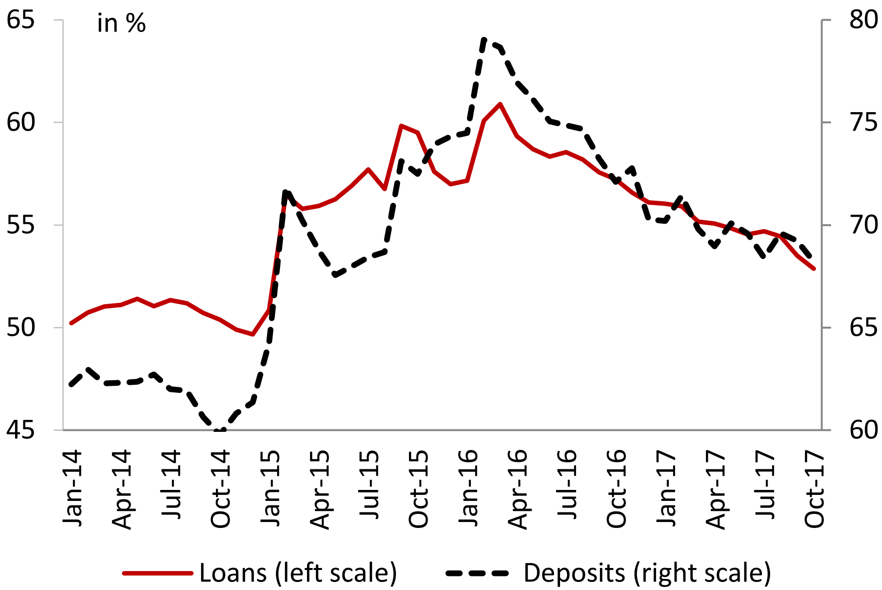
Source: Joint Resolution of the Council of Ministers and the National Bank No 923/28 from 15 November 2016

- The Asset Management Agency (AMA) was founded by Decree of the President #268 as of July 14, 2016
- Tasks:
  - Acquisition of certain non-performing agricultural loans from commercial banks and the Development Bank
  - Pretrial financial recovery of borrowers
  - Provision of deferral (installments) of principal repayment on loans and for interest payments on the loans provided by the Development Bank
- Two transfers of toxic assets of 356 agricultural organizations (BYN 766.8 m) at face value
- So far, no comprehensive, tailor-made restructuring of problem assets due to a lacking legal framework

⇒ For a successful restructuring of problem assets, AMA needs a comprehensive legal framework

14. Initiatives for De-Dollarization

Dollarization of loans and deposits



Source: NBB, own calculations

- In the first half of 2017, the NBB took some measures on de-dollarization:
  - Loan loss provisioning requirements for foreign currency loans were tightened
  - Reserve requirements were increased up to 15% on foreign currency deposits and decreased down to 4% on deposits in national currency
- Further measure aim at boosting payments made in local currency
- As a result, the currency structure of the loan portfolio and the money supply continues to improve gradually
  - The share of foreign loans and deposits reduced to 53% and 68% respectively

⇒ Historically low inflation and a relatively stable exchange rate support de-dollarization initiatives

Annex: Bank sector statistics (excluding Development Bank)

Balance sheet data	2013	2014	2015	2016	Oct 2017
Total assets , BYN m	39,516.35	48,153.08	63,046.33	64,467.00	64,416.10
growth in % yoy	23.00	21.90	30.90	2.30	1.58
in % of GDP	62.06	61.86	72.49	68.35	63.46
Total loans, BYN m	25,939.09	31,398.86	37,777.12	35,851.00	37,551.50
growth in % yoy	28.40	21.05	20.30	-5.10	1.20
in % of GDP	40.70	40.30	43.40	38.01	37.00
Loans to private enterprises, BYN m	7,944.55	10,334.20	13,198.06	11,860.20	12,242.70
growth in % yoy	19.20	30.08	27.70	-10.10	-4.59
in % of GDP	12.50	12.30	15.20	12.57	12.06
Loans to households, BYN m	5,397.12	6,293.61	6,878.84	7,155.40	8,269.00
growth in % yoy	34.30	16.60	9.30	4.02	19.62
in % of GDP	8.50	8.09	7.90	7.59	8.15
Loans in foreign currency, BYN m	13,027.58	15,969.46	21,593.86	20,089.10	19,855.00
growth in % yoy	41.80	22.60	35.20	-6.97	-6.49
in % of GDP	20.50	20.50	24.80	21.30	19.56
Loans in foreign currency (% of total loans)	50.22	50.86	57.20	56.03	52.87
Total deposits, BYN m	17,267.66	21,427.28	29,520.66	29,946.00	31,898.21
growth in % yoy	19.50	24.10	37.80	1.44	10.83
in % of GDP	27.10	27.50	33.90	31.75	31.43
Deposits from households, BYN m	10,233.85	13,433.30	19,272.04	19,074.20	19,804.70
growth in % yoy	31.10	31.30	43.50	-1.03	5.44
in % of GDP	16.10	17.30	22.20	20.22	19.51
Total loans (% of total deposits)	150.20	146.50	127.97	119.72	117.72
Structural information					
Number of banks	31	31	26	24	24
Market share of state-owned banks (% of total assets)	63.70	63.40	63.80	66.65	65.05
Market share of foreign-owned banks (% of total assets)	33.18	33.23	33.75	30.78	32.17
Profitability and efficiency					
Return on Assets (RoA)	1.9	1.7	1	1.3	1.0
Return on Equity (RoE)	13.8	13.1	8.4	10.8	10.9
Capital adequacy (% of risk weighted assets)	15.5	17.4	18.7	18.6	19.0
NPLs (% of assets subject to credit risk)	4.45	4.37	6.80	12.80	12.80

Source: NBB, Belstat, own calculations

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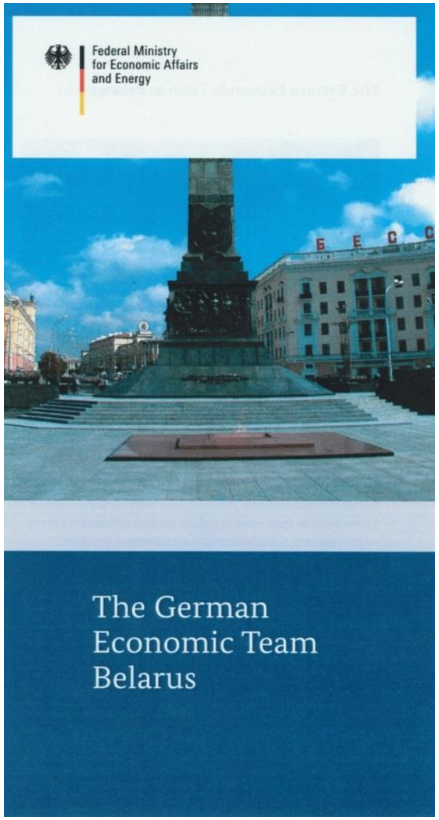

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