

## Banking Sector: Gradual improvement, but challenges remain

The banking sector in Belarus mirrors the overall economic picture: After some rather difficult years 2015-2016, when credit extension was shrinking, the interest rates were very high, and the level of bad assets was rapidly increasing, some stabilisation and recovery has gained pace.

In line with the moderate economic expansion (real GDP expanded by 2.4% in 2017) the sector is again growing its loan book in nominal terms; interest rates have decreased significantly, also due to a better inflation performance.

This welcome cyclical improvement should not hide the fact that significant structural challenges remain. One of these, the high level of dollarisation, is being successfully addressed by the National Bank. Another legacy of the crisis, the high level of bad debt still needs to be tackled in a comprehensive manner.

### The banking sector in a regional context

In Belarus, there are currently 24 banks operating. At the end of 2016, bank assets to GDP amounted to 67% of GDP, an increase of 14 percentage points over 2014. This is, however, more a combination of significant foreign currency assets in a period of high depreciation rather than genuine growth and financial deepening.

If one looks only at credit issued to the private sector, which excludes e.g. state-owned enterprises, some key differences to neighbouring countries become evident: With 22% of GDP, this indicator is significantly lower than e.g. in Poland and Russia and a reflection of the prominent role that the state continues to play in the economy. Even Ukraine with its severe banking crisis has a respective share that is about twice as high.

Ratio of credit to private sector to GDP

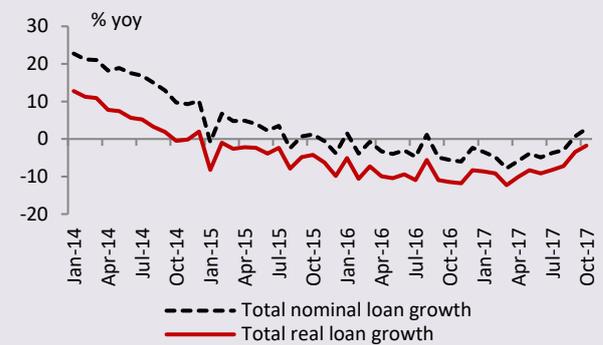


Source: Own calculation based on IMF data

### Recent developments

A key banking sector indicator is loan growth. While in early 2014 the loan book was still expanding at double-digit rates, by the summer 2015 this development reversed, and the portfolio started to shrink. Only in the second half of 2017 the sector began to grow again, supported by the economic recovery. Real GDP expanded by 2.4% in 2017 after two years of decline.

### Loan growth

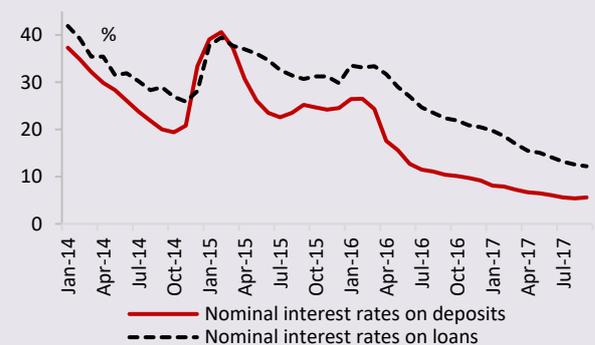


Source: NBB, Note: FX adjusted

While a continuation of this positive trend can be expected, one should not overlook the fact that in real, i.e. inflation-adjusted terms the loan book is still shrinking, a process that started already in early 2015.

One reason for the observed moderate credit expansion is the reduction in interest rates. The National bank decreased its monetary policy rate in line with falling inflation (currently: 4.5% yoy). This caused loan and deposit rates to fall: Local currency loan rates stand currently at 12%, after 39% in 2015.

### Interest rates on BYN loans and deposits



Source: NBB; corporate and household loans and deposits

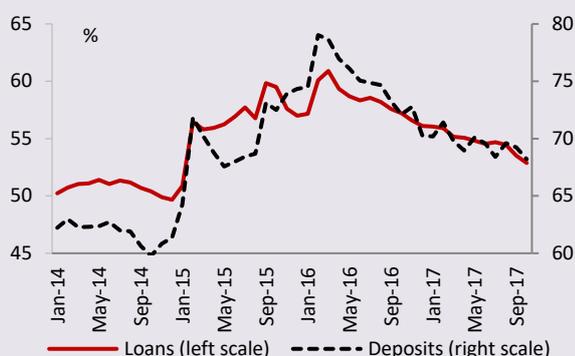
The share of non-performing loans is with 12.8% still rather high. While the strong growth in this indicator was stopped at the end of 2016 when some bad assets were transferred to the Asset Management Agency (AMA), the problem still needs to be resolved in a comprehensive manner.

### Structural problem: Dollarisation

As in many other emerging and transition countries, a significant share of both loans and deposit is denominated in foreign currencies, in particular the US dollar. This share amounted to about 50% (for loans) and 60% (for deposits) in 2014. During the economic crisis of 2015-16, and the associated devaluation of the currency, these shares peaked at about 60% (loans) and almost 80% (deposits).

The National Bank responded with a strategy of de-dollarisation, which helped to reverse the picture since 2016, as the following figure shows:

Dollarisation of loans and deposits



Source: NBB, own calculations

As part of this strategy, loan loss provisioning requirements for foreign currency loans were tightened; reserve requirements were increased on foreign currency deposits and decreased on deposits in national currency. Further measures aimed at boosting payments made in local currency. While dollarisation is still somewhat higher than before the crisis, the reversal of the trend is a positive development.

### Summary and outlook

Recent developments underline a gradual stabilisation of the banking sector in Belarus after some rather difficult years. Credit growth has finally turned the corner, supported by decreasing interest rates. Economic growth has finally returned and financing conditions have relaxed, as evidenced by the sovereign’s return to the Eurobond market.

However, the economic recovery that is driving this improvement is rather modest. Medium-term real economic growth of around 2% p.a. does not suggest a significant improvement in asset quality. Thus, certain risks remain that need to be addressed by policymakers. First and foremost, this relates to the significant stock of non-performing loans, which are often related to over-indebted state-owned enterprises. These two sides of the same coin need to be addressed by the authorities in a comprehensive manner to the benefit of both, financial and real sector.

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