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Will IMF Intervention Help Belarus Solve Its Old Problems?

By Alexander Chubrik

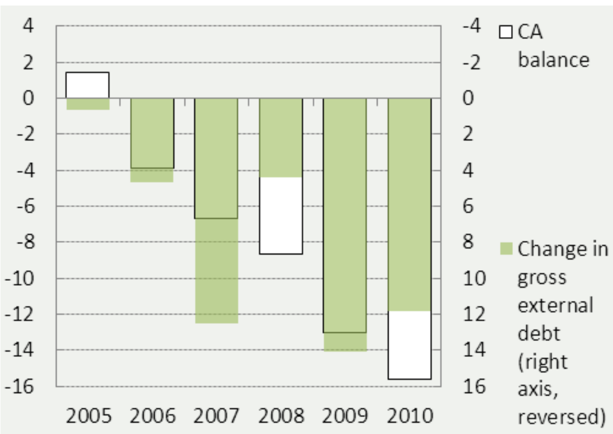
On May 31, 2011 the Government and National Bank of Belarus (NBB) announced that they would ask for a new stand-by loan from the IMF. The next day, it was reported that the 3-5 year stabilization program would amount to between SDR 2.2–5 billion. On June 4th, the Anti-Crisis Fund of the Eurasian Economic Community approved a 3-year stabilization loan to Belarus in the amount of USD 3 billion. The requests for external assistance followed several unsuccessful government attempts to overcome the serious macroeconomic crisis that has been developing since the beginning of 2010.

However, the key question arises: can external loans help Belarus to overcome its current crisis?

Balance of Payments Crisis

The current situation has its roots in persistent and growing external imbalances: between 2005–2010 the current account (CA) balance fell from +1.4 to -15.6% of GDP, financed by external debt[1], which increased in gross terms from less than 20% of GDP at the end of 2006 to more than half of GDP at the end of 2010 (see Figure 1).

FIGURE 1: CURRENT ACCOUNT DEFICIT AND ITS FINANCING VIA EXTERNAL DEBT INCREASE, % OF GDP



Source: Own estimates based on the NBB and Belstat data.

The structure of external debt has also changed. Before 2007, 90% of Belarus's debt was accumulated by the corporate sector and banks. Since 2007 (the year when Russia more than doubled its gas price for Belarus) the government's external debt increased dramatically, exceeding 40% at the beginning of 2011.

Problems first appeared in the fourth quarter of 2008, when the quarterly current account (CA) deficit approached 15% of GDP. At that time authorities decided to keep the exchange rate fixed until the end of the year, and devalued the Belarusian ruble by 17% in early January 2009. Throughout the crisis authorities intervened in the currency markets in order to satisfy the demand for foreign currency. Moreover – already in late 2009 – households re-established their confidence in the domestic currency and started to increase ruble-denominated deposits. External borrowing – mainly through an IMF stand-by loan of SDR 2.27 billion – made these interventions possible.

However, as seen from Figure 1, implementation of the stabilization program had not led to a reduction of the CA deficit. Instead, it increased in 2009 and continued to grow in 2010.

On the Way to Currency Crisis

More importantly, in 2010 (which was an electoral year) stabilization policies were completely reversed: investment (financed by more than 2/3 by bank loans, mainly preferential ones) started to grow rapidly in the second quarter of 2010, wages (mainly due to administrative increases) – since the beginning of the year. As a result, domestic demand increased by 10.9% after a reduction by 1.1% in 2009. Consequently, real imports increased by 9.2% in 2010 after their decline by 10.6% in 2009, while real exports grew by only 2.5% (after an 11.2% decline in 2009).

[1] Between 2006 and 2010, net FDI inflow financed only 30% of CA deficit.

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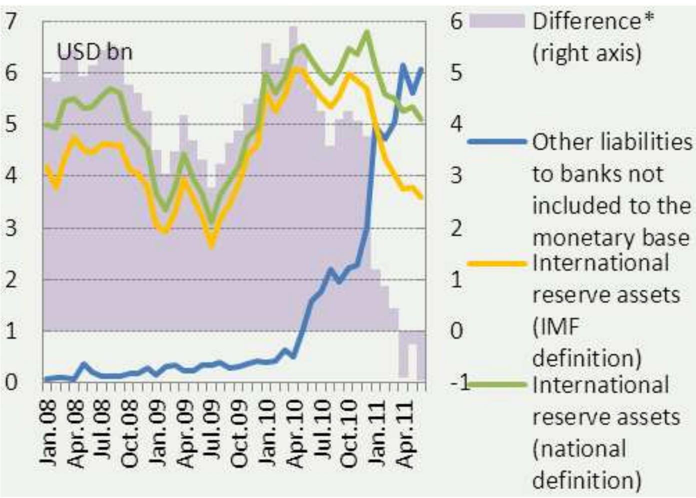
Thus, external imbalances were boosted by growth-enhancing pre-electoral policies. Net purchases of foreign currency by Belarusian residents in the domestic currency market amounted to USD 400 million per month between 2008 and 2010.

Expectations and Tricks

Since the end of 2010 devaluation expectations became another key challenge for the NBB. First, households started to pay attention to the size of the NBB's gross international reserves, and reacted to their decrease with higher demand for foreign currency. Second, any tendency towards modest currency depreciation was considered a signal for future devaluation. Third, expectations were also fed by the presidential elections in December 2010, and the fear that authorities will conduct a devaluation right after the New Year (similarly to 2009). As a result, households dramatically increased their demand for foreign currency in the fourth quarter of 2010 (similar to the end of 2008).

In this environment keeping stable exchange rates required permanent NBB interventions in the foreign exchange market. In order to avoid panic the NBB resorted to data manipulation by borrowing foreign currency from commercial banks on the 1st day of the month, when it published statistics on international reserves. For example, on November 1, 2010, the NBB reported reserves of USD 6.1 billion, while in reality (without swaps with commercial banks) this amount was equal to just a fraction at USD 1.2 billion (see Figure 2).

FIGURE 2: GROSS INTERNATIONAL RESERVES AND THE TRICK WITH THEIR "FILLING"



Source: * International reserve assets (national definition) minus other liabilities to banks not included to the monetary base.

Chaotic reactions of the NBB

In January 2011 the NBB narrowed its exchange rate band and even slightly revaluated the Belarusian ruble against the currency basket. Together with misreporting reserves this allowed for the reduction of household demand for foreign cash for two months.

However, on January 13th the NBB started a gradual devaluation of the national currency against the basket. In addition, it introduced a restriction on advance payments of imports.

During a mid-March press-release the NBB rejected the possibility of devaluation and promised to meet household demand for foreign currency. However, the day after the Belarusian Currency and Stock Exchange increased the length of import deposits in Belarusian rubles. This measure led to multiple exchange rates, i.e. the black market premium on an interbank market (see Figure 3). One week later the NBB suspended the legal foreign exchange cash market as it stopped selling currency to banks in exchange for re-selling to households.

In April, authorities started to talk about the possible "legalization" of multiple exchange rates regimes – specifically the introduction of additional sessions at the Belarusian Currency and Stock Exchange on which the exchange rate would be fixed based on supply and demand. However, this plan was never implemented and the NBB promised exchange rate unification in May. In the beginning of May the NBB formally cancelled limits on cash exchange rates offered by banks, but *de-facto* it "recommended" an exchange rate ceiling.

Later it increased this ceiling, but both measures pushed the black-market exchange rate to more than 150% of the official one. Finally, on May 23rd, the NBB announced exchange rate unification and since May 24th it devalued the Belarusian ruble against three currency baskets by 35.2%. The new exchange rate was set at the level of the late April interbank exchange rate. This is why multiple exchange rates persisted, although the black market premium fell to approximately 40%. On top of this, the NBB re-introduced limits on possible deviations of exchange rates from the official rate (±2%), and thus, made transactions at lower exchange rates illegal.

The first five months of 2011 provided at least two pieces of important evidence. First, it demonstrated the inability of authorities to implement consistent and comprehensive policies. Even after devaluation there is no current account convertibility of the Belarusian ruble. Second, these months demonstrated a drastic fall in household confidence in the national currency and, unlike 2009, to the banking system as well.

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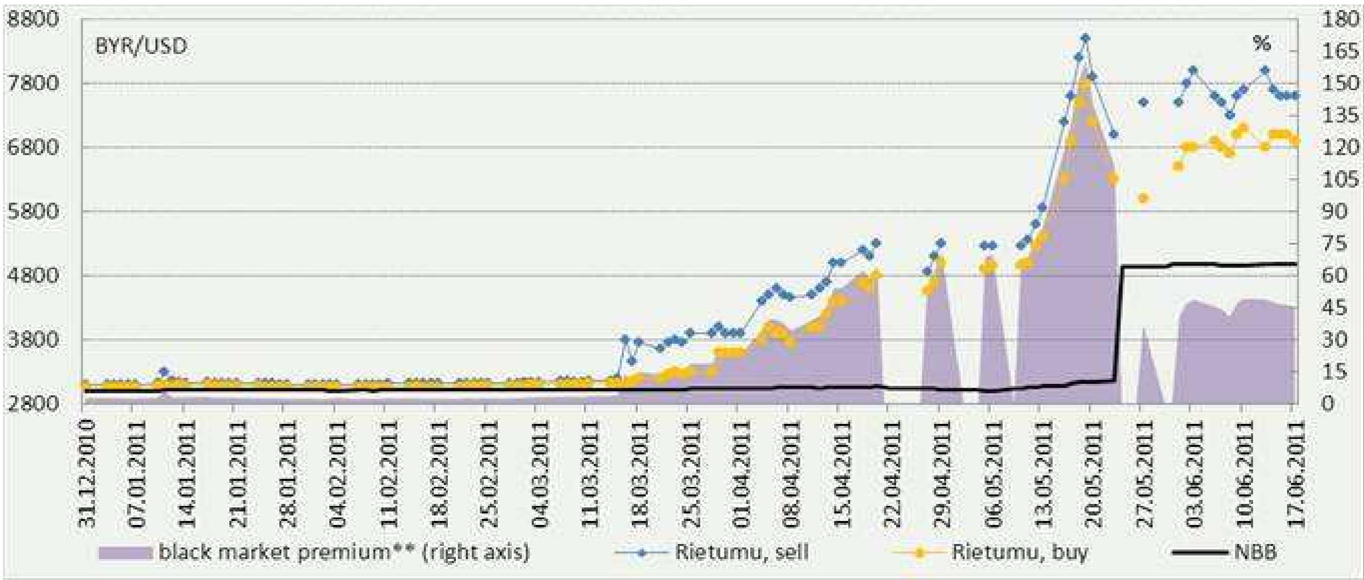
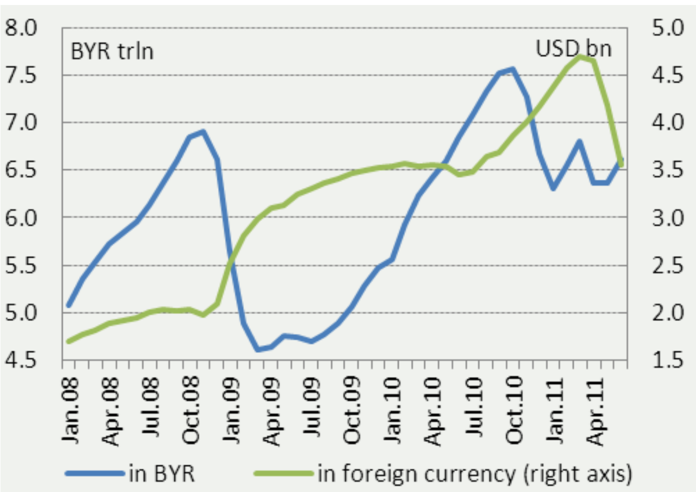
Figure 3: exchange rate dynamics in 2010: non-cash markets* vs. official exchange rate



* Non-cash market exchange rate is exchange rate set by Latvian bank 'Rietumu Banka'. Information about daily interbank exchange rates is not available, but based on publications in mass media one can say that Rietumu's exchange rate is similar to Belarusian interbank exchange rates.
** Black market premium is calculated as a ratio of difference between simple average of buying and selling rates in Rietumu bank and NBB's exchange rate to NBB's exchange rate (measures in %).
Sources: official exchange rate http://nbrb.by/engl/statistics/rates/ratesDaily.asp, non-cash (black) market exchange rate – http://www.rietumu.ru/fx-rates.

While in late 2008 and early 2009, one could observe a fall in household time deposits in national currency and a rapid growth of those in foreign currencies, in 2011 households started to withdraw deposits in both currencies (see Figure 4). Fortunately, it has yet to result in a bank run.

Figure 4: Household time deposits, EOP



Source: NBB

Lessons From Previous Crisis

Requests for external financial assistance followed a substantial, although insufficient devaluation. Thus, what is the purpose for additional lending? Would it support a devaluation effect on external imbalances?

To answer this question it makes sense to remember the 1998 currency crisis. The CA deficit, which exploded in 1997 as a result of rapid economic growth financed by credit expansion, reached the level of 15% of GDP in 1998. At that time, Belarus had a multiple exchange rate regime (black market premium varied from about 30% in 1997 to 470% at the beginning of November 1998) and 2 to 3 digit inflation, which meant the NBB did not control the money supply. The market reacted to these growing imbalances with a depreciation of the Belarusian ruble. For a while, the CA deficit was financed via an increase of import arrears, including overdue ones. Having no other important sources of CA deficit financing, Belarus had to correct external imbalances. This is similar to what happened in 1999, when the CA deficit fell to 3.6% of GDP.

However, the experience of 2009 was completely different. First, a multiple exchange rate regime did not return and inflation was kept at around 10% yoy. Second, the NBB controlled the situation in the foreign exchange market and banking system. Finally, the CA deficit could be financed by the IMF stand-by loan and other loans.

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The result, the CA deficit continued to increase. Moreover, the IMF loan enabled the NBB to preserve control over the exchange rate as well as household behavior. But it was also the IMF and other loans that allowed the government to continue its unsustainable macroeconomic policies.

The Role of the IMF

The IMF evaluated ex-post the 2009 stand-by arrangement[2] as "generally successful". However, it also pointed out to several shortcomings in its design and implementation. For example, Belarusian authorities found ways to bypass program requirements concerning lending under government programs, and exceeded agreed limits several times. More generally, quasi-fiscal operations were mentioned as one of the most important sources of macroeconomic imbalances. However, despite these shortcomings, the program went uninterrupted.

As a main lesson, the IMF named "the criticality of incorporating full ownership, including at the highest levels, in program design and conditionality". Finally, the Fund concluded, that "given the importance of ownership, explicit endorsement of the goals of any future program should be secured at the very highest levels. Ideally, this should also be combined with an approach that sets critical measures as prior actions."

Apart from the 2009-10 stand-by, the IMF has other experiences of working with Belarus. During 1995-96, it approved a 12-month stand-by loan "to support the government's reform program". That time it disbursed only one-quarter of the approved amount of credit, as authorities did not meet the program criteria. The irony of Belarus-IMF relations is that "the very highest levels" of Belarusian authorities remained unchanged between these two programs, creating some doubts about the ability of the Fund to ensure full ownership over "any future program" and, especially, its conditionality.

The idea of "setting critical measures as prior actions" is far more helpful in the current situation. First, all restrictive policies of the NBB on the foreign exchange market should be reversed in order to re-establish full current account convertibility of the Belarusian ruble. Second, quasi-fiscal operations of the government should be reduced significantly, and ideally, included into a consolidated budget (as it has been proposed by the IMF). Third, serious microeconomic restructuring should be launched, including revision of bankruptcy legislation. The size of the current account deficit (say, 3% of GDP) should serve as the main quantitative pre-condition of the new program. Under such conditions the new program could help to return confidence to the banking system, national currency and government's economic policy.

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[2] Republic of Belarus: Ex Post Evaluation of Exceptional Access Under the 2009 Stand-By Arrangement, *IMF Country Report* 11/ 99, http://www.imf.org/external/pubs/ft/scr/2011/cr1199.pdf.

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