Liquidity and Monetary Policy in Belarus

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Abstract. High inflation and devaluation expectations after the 2011 currency crisis force Belarusian monetary authorities to seek non-conventional policy measures. Instead of using the refinancing rate as an instrument on the money and credit markets, the National Bank of Belarus resorts to liquidity squeezes, which drive up the rouble interbank rates. The banks have to raise deposit and loan rates in response. As a result, households continue to keep savings in the national currency deposits, while firms struggle to keep up with the payments. This situation, however, will have to end soon.

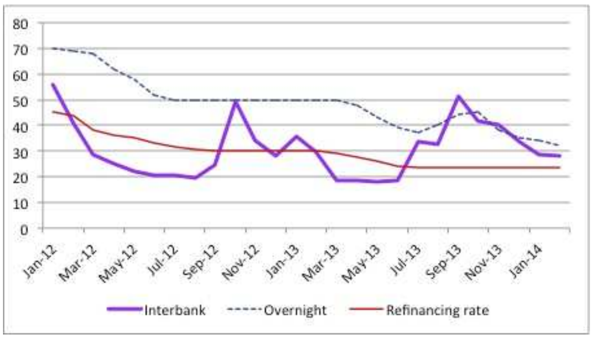
Belarusian economy is characterized by state ownership domination and various (including political) constraints. This often makes it tempting for the Belarusian authorities to resort to untraditional policy measures, or use the conventional policies in unexpected ways. A good example is Belarusian monetary policy in 2012-2013. In 2011 Belarus experienced a severe currency crisis: the exchange rate of the Belarusian rouble (BYR) crumbled from 3011 BYR per USD in January 2011 to 8470 BYR in December 2011. Prices followed the currency and doubled: in 2011 the inflation rate was 108%. Due to high government influence on the labor market and competition from the Russian labor market, real incomes quickly recuperated (Bornukova, 2012). But the owners of the deposits in Belarusian roubles took a hit – their savings lost almost a half of real value. More and more people converted their deposits into USD or other foreign currency. Inflation and devaluation expectations were soaring (Kruk, 2012).

The National Bank of Belarus clearly realized that the proper response would be to increase the interest rates: this policy measure would partially compensate the losses of rouble deposit holders, make rouble deposits attractive again and curb the growth in lending, one of the major causes of the currency crisis.

However, there is a catch. Formally, the main monetary instrument of the National bank is the refinancing rate. Yet, despite the name, this is not the rate at which the National bank is refinancing the commercial banks. Officially, it is only a "basis for setting interest rates on the operations involving liquidity provision to banks". The problem is that most of the floating rates, especially those on concessional loans, have the refinancing rate as its basis rate. Very high refinancing rate would hurt debt-financed organizations, in particular in agriculture and construction. And the National bank found a compromise: the refinancing rate would remain relatively low; but the National bank would regulate the money market through liquidity squeezes: it would offer liquidity to the commercial banks only at a much higher collateral loan and overnight rates. The lack of liquidity due to a squeeze would drive up the interest rates on the interbank market.

Figure 1 shows the main interest rates in Belarus in 2012-2014. The refinancing rate was steadily decreasing throughout the whole period. The overnight rate (which moves together with the collateral loan rate), also set by the National bank, for some period was almost two times higher than the refinancing rate, reaching 70 percent at its peak. The overnight rates mostly

Figure 1: Main interest rates in Belarus in 2012-2014

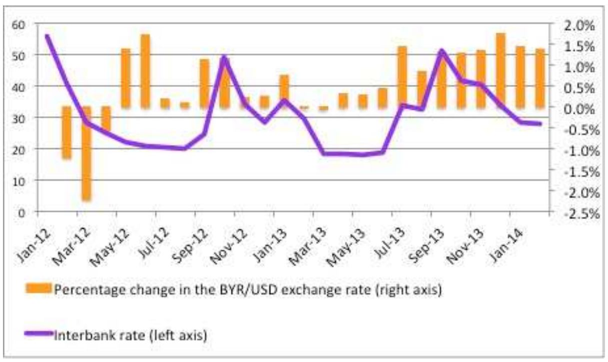


Source: The National Bank of the Republic of Belarus.

exceeded the rate set in the interbank market. The interbank rate reflects the market price of liquidity. The National bank influences this rate by offering (or not) liquidity to the state-owned commercial banks.

The National bank has successfully used liquidity squeezes as an instrument of stabilization on the currency market. As Figure 2 shows, the two major spikes in the interbank rate coincided with the higher rates of currency devaluation. The first major devaluation episode began in the autumn of 2012. At that time the market reacted to the increased lending and the news about the ban on the exports of "solvents", which meant Belarus would have to pay back to Russia the customs duties on oil. On the other hand, the periods of high liquidity and low interbank rates were usually followed by devaluation episodes.

Figure 2: Changes in the exchange rate and the interbank rate, 2012-2014

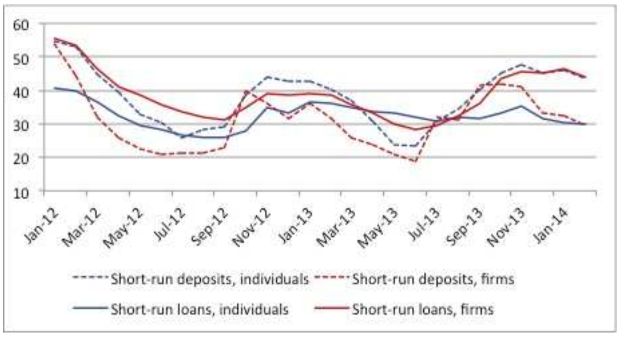


Source: The National Bank of the Republic of Belarus.

In the summer 2013 devaluation speeded up once again, fueled by the potassium scandal. The National bank responded with lower liquidity and higher rates, which reached peak values of 50% and higher in September 2013.

Of course, this policy had other effects besides calming the currency market. As Figure 3 demonstrates, deposit and credit rates mainly reacted to the changes in the interbank rate, with peaks in the autumn of 2012 and summer-autumn of 2013. Enormously high deposit rates (often higher than 40 percent) delivered a hefty real rate of return given inflation of 22 percent in 2012 and 16 percent in 2013. Rouble deposits were growing throughout the period. But someone had to pay those rates.

Figure 3. Short-run deposit and loan rates for firms and individuals



Source: The National Bank of the Republic of Belarus.

High real rates became a burden for firms and households. The commercial banks had to stop many of their long-term individual lending programs (mainly those financing housing purchases). Instead, the banks put their efforts into the development and promotion of short-term consumer credit, which was virtually non-existent just a couple of years before. Many firms switched to cheaper loans in U.S. dollar, but the National bank quickly shut down these practices by introducing restrictions on foreign currency loans. Credit growth slowed down, and did not decline only due to the government-sponsored lending programs and a boom in consumer credit.

High loan rates together with the growing wages and low sales suffocated the firms. Average profitability across the country is declining since summer 2012, reaching the record low profit margin and negative aggregate net profits in

December 2013 (see Figure 4). The lack of liquidity lead to the crisis of payments: accounts receivable and accounts payable on the 1st of February 2014 were 24.7 and 31.6 percent higher than a year before.

Figure 4. Average profit margin in Belarus, 2012-2014

Source: The National Statistical Committee of the Republic of Belarus

Today Belarus experiences high pressure for devaluation. The international currency reserves are depleted; the current account balance is in the red for a long time. The exporting enterprises quickly lose competitiveness due to low productivity. For the first time since 2009 GDP growth is virtually non-existent (and even negative in the first months of 2014). Some of the main trading partners – Russia, Ukraine and Kazakhstan – have already devaluated their currencies and face uncertain prospects for growth. It looks like the successful practice of fighting devaluation with liquidity squeezes at the cost of the real economy will have to end soon.

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