Monetary Policy in Belarus since the Currency Crisis 2011

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In the second half of 2010, the National Bank of Belarus carried out a soft monetary policy to stimulate domestic demand. Until March 2011, the country experienced strong economic growth. There was an increase in real incomes with parallel increase in the negative trade balance and the reduction of international reserves. Stimulating policy became one of the reasons for the formation of a multiplicity of exchange rates on the foreign exchange market. Beginning of March and until the end of October 2011, there was an official and gray currency market in the country. High domestic demand and rapid devaluation processes led to the deployment of an inflationary spiral, which in turn meant a decrease in the growth of real incomes.

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The reaction of monetary authorities to the aggravation of the situation on the foreign exchange market and the acceleration of inflation was a tighter monetary policy. Against the background of accelerating inflation, the National Bank began to increase the refinancing rate and the rate for operations of the National Bank in order to prevent the development of negative tendencies on the domestic currency and deposit market. Accordingly, all rates on the deposit and loan market were raised.

In order to maintain the attractiveness of ruble deposits in banks under the conditions of high inflation, the refinancing rate was increased from 10.5% in the beginning of the year, to 18% in June 2011. At the same time there was an increase of rates for permanently available operations on liquidity support. The tightening of monetary policy was also characterized by a decline in the bank requirements in terms of both rubles and foreign currency. In April, bank requirements decreased by 4% points. Thus, the monetary base increased by 11%. The National Bank limited the supply on lombard auctions and provided more expensive credits called "overnight."

The growth of the monetary base, as well as the money supply, occurred largely due to growth of cash in circulation. In April 2011, it increased by around 21%. Such a tendency was not connected with the easing of monetary policy, but with the limitations on the foreign exchange market. In previous months, the population was buying currency actively, which absorbed part of the money from circulating. In April 2011, the market of currency stopped. People got the income, but the withdrawal of currency from circulation through the purchase was not there. The growth of cash in circulation was also affected by the reduction of deposits in national currency. Deposits of legal entities and individuals in foreign currency also declined. The decrease was due to the partial withdrawal of currency from public deposits because of problems on the foreign exchange market, as well as to some reduction in foreign exchange funds on the accounts of business entities. However, the withdrawal of deposits in April 2011 was not critical.

Tensions on the monetary market declined and were maintained in May. In Belarusian ruble, equivalent foreign currency deposits of physical persons and legal entities increased by 47% and 71%, respectively. Nominal growth of foreign currency deposits in rubles was a consequence of a sharp devaluation of the Belarusian ruble to the U.S. dollar. In fact, in May 2011, the population withdrew 469 million U.S. dollars (or 12.6% of total deposits in foreign currency), and in spring withdrawal of deposits in foreign currency amounted to approximately 969 million U.S. dollars (or 26%). This tendency indicates that individuals not only lost confidence in the Belarusian ruble, but in the banking system as a whole. Withdrawal of deposits by the population negatively affected the liquidity of banks.

Due to lack of liquidity in the banking system, the National Bank continued in May 2011 its refinancing operations of banks in limited quantities. The commercial bank requirements of the National Bank increased both in rubles and foreign currency. Moreover, the main increase was in foreign currency requirements. At the same time, the support of the banking system was not of a mass character and was mainly related to the revaluation of liabilities at the new rate of the Belarusian ruble.

During the summer months, the monetary authorities continued to implement tight monetary policy. Under the arrangements for obtaining credit from the EurAsEC, the National Bank ceased to exercise direct emission. In addition, against the background of galloping inflation, the National bank of Belarus continued to increase the refinancing rate and interest rates on liquidity management operations in order to prevent the development of negative tendencies on the domestic currency and deposit markets. Accordingly, all rates were raised on the money market as well.

In order to maintain the attractiveness of ruble deposits in banks under conditions of high inflation, the refinancing rate was gradually increased. By the end of August, it reached 22%. Simultaneously, there was an increase in rates on permanently available operations of liquidity support up to 32%.

In the first half of 2011, there was a tendency of bank assets slowdown. The reasons for the bank assets slowdown were the rapid growth of rates on resources provided by banks, reduction of investment financing under the government programs, as well as the suspension of preferential home loans.

On the deposit market, there was a tendency for a decrease of the population’s deposits in foreign currency. While at the end of March 2011, population deposits in foreign currencies accounted for 63% of total foreign currency deposits, its share had dropped to 55% by the end of July the same year. Until the end of August, the population's deposits in national currency remained at approximately the same level in nominal terms but declined in real terms taking into account high inflation.

Due to the implementation of tight monetary policy by the National Bank, the government increasingly started to put its own funds in the accounts of commercial banks. This increased the banks’ liquidity. The inflationary increase of government revenues also contributed to this. Public authorities significantly increased their own funds on commercial banks deposits. Only in August 2011, the government’s deposits increased by approximately 1 billion rubles. Limiting the supporting emission of the economy by the country's main bank was partially offset by cash injections from the government.

Thus, on the one hand, from April 2011 there was a tightening of monetary policy and limit of budget spending which led to an economic growth slowdown with a parallel decrease in the monthly inflation rate, the negative trade balance, and the building up of foreign reserves. At the same time, there was an increase of inflows into the banking system by the government.

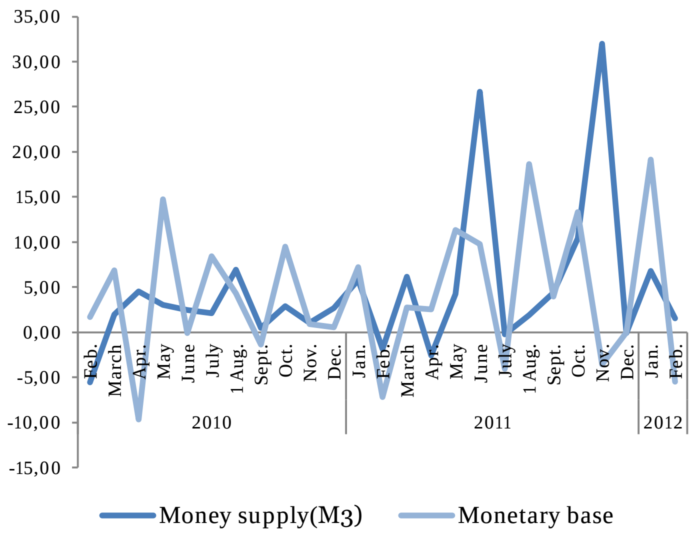
In September 2011, the National Bank took a number of decisive actions for establishing a single rate of the Belarusian ruble. On September 14, 2011 the National Bank opened currency trades on the extra session of the Belarusian Interbank Currency and Stock Exchange. From this day, two rates of the Belarusian ruble to foreign currencies were officially established in Belarus - one was an official rate, and the other was a market one. The principles of rates establishment were unified. The only difference was that everyone willing to buy currency was allowed to the extra session and only the importers of strategic import were allowed to the main one. The purpose of the additional session was to determine the real market rate of the Belarusian ruble.

The second phase on the way to a single exchange rate was the decision to introduce a single trading session since October 20, 2011. In fact, this meant the closure of the main trading session and all the trades were focused on the former extra session. From October 20, 2011 buying and selling rates of foreign currencies were installed on a single trading session of the "Belarusian Currency and Stock Exchange" on the results of the fixing on the basis of supply and demand. At the same time, the National Bank could perform minimum interventions to smooth sharp fluctuations of exchange rates. Since the beginning of 2011 till October 21, the same year, the Belarusian ruble was devalued against the basket of currencies by 190% and against the U.S. dollar by 189%.

The output to a single exchange rate affected positively the overall situation on the monetary market. At the same time, to maintain the high inflation, the National Bank continued to implement tight monetary policy.

Refinancing rate was increased from up to 27%, on September 1, to up to 35%, on October 14. This was done in order to maintain the attractiveness of ruble deposits in banks under conditions of high inflation. At the same time, there was an increase of rates on permanently available operations on liquidity support up to 50% in October 2011.

Figure 1. Dynamics of Monetary Aggregates



Source: Bulletin of banking statistics № 1 2012

In September, as well as in April 2011, there was a sharp increase in cash circulation. The cash growth was largely associated with increasing supply of foreign currency by the population. Ability to freely buy and sell foreign currency at market rates from mid-September caused an increase in its offer from the part of the population. Deposits growth in the banking system resumed since September 2011.

The transition to a single rate contributed to the activity of interbank foreign exchange transactions. Volumes of currency transactions on the exchange and over-the-counter market recovered. Till the end of 2011, the functioning of the money market was characterized by a moderate stability with continuing rise of interest rates. Under the conditions of high inflation and public mistrust of the Belarusian ruble, the National Bank raised its refinancing rate up to 45% in December. Accordingly, all bets on the money market rose. Thus, in September - December 2011, the National Bank continued to implement tight monetary policy that resulted in the slowdown of economic growth and helped improve the situation on the foreign exchange market.

At the beginning of 2012, the rate of economic growth declined because of investment activity slowdown. At the same time, macroeconomic environment was characterized by a stable performance of the industrial sector, inflation slowdown and stable exchange rate.

During 2012, the gradual decline in the refinancing rate and the rates on constantly available instruments are expected to be under the condition of a gradual inflation slowdown. In mid-February, the refinancing rate was reduced to 43% per annum. From March 1, 2012 the National Bank announced a reduction of the refinancing rate to 38%, and from April 1, 2012 up to 36% per annum. The decrease in interest rates by the National Bank was due to an inflation slowdown, ruble liquidity excess and foreign currency liquidity in the banking system. Extremely high rates on deposits with moderate inflation make deposits very attractive, especially the ruble ones. At the same time, excessively high interest rates on loans do not allow many business entities to obtain the necessary credit funds.

At the beginning of 2012 the high rates on ruble resources limited consumer credit restricted opportunities for individuals and entities to obtain loans in local currency. Calls of banks for individuals fell by 81 billion Br. Rub. in January 2012, and legal calls remained unchanged. However, the increase of enterprises' liabilities in foreign currency indicated an increase in the attractiveness of foreign currency loans. The stabilization of the situation on the foreign exchange market, the excess liquidity of banks in foreign currency encouraged banks to create more attractive conditions for foreign currency loans. As a result, enterprises were active in this segment of the credit market. The calls of commercial banks to legal entities in foreign currency rose by 253 million USD (3.6%) last month.

Thus, the National Bank continued to implement tight monetary policy at the beginning of 2012 by limiting the amount of liquidity supplied to commercial banks and by maintaining high rates of liquidity operations. Banks did not seek to attract additional resources from the National Bank due to their high cost and adequacy of resources in the interbank market. Net claims of banks to the National Bank increased by 1.1 trillion. Br. Rub. in January 2012. The main reasons for growth were the increase of requirements to the National Bank and decrease of requirements of the National Bank for banks since the beginning of the year.

Attractive rates on term deposits and stabilization of the foreign exchange market situation stimulated the increase in enterprise deposits in foreign currency and the growth of term deposits in foreign and local currency. Factors such as the transition to a single exchange rate, high interest rates on bank deposits and limited alternative savings for individuals contributed to the inflow of public funds into banks. However, the term deposits growth in national currency was affected by high interest rates (some banks rates were higher than 60% per annum). In the case of the capitalization of interest on such deposits, it was possible to provide a sufficiently rapid growth. The decrease in interest rates on credit and deposit market would slow deposit growth with a parallel revival of the situation on the credit market.

The performance of the economy in 2011 and the beginning of 2012 was strongly influenced by the devaluation of the Belarusian ruble and high inflation theme. In the beginning of 2011, the country experienced strong economic growth with a parallel increase in the negative trade balance and the reduction of international reserves. In the second and third quarters of 2011, a permanent shortage of currency was formed on the foreign exchange market which led to a multiplicity of exchange rates. High domestic demand and rapid devaluation processes led to the deployment of an inflationary spiral, which in turn provoked a decrease in real incomes.

Thus, the stabilization of the situation on the external sector and the foreign exchange market became possible due to the National bank conducting tight monetary policy with simultaneous tightening of fiscal policy since the first half of 2011. All this contributed to a slowdown in economic growth with a parallel decrease in the monthly rate of inflation, a slowdown in the negative trade balance, and an increase of the country's foreign exchange reserves, as well as output to a single exchange rate in late 2011. Maintainance of macroeconomic balance in 2012 will be implemented by moderately tight fiscal and monetary policies, stimulation of foreign direct investments and an improvement of export policy efficiency.

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