

Belarus Economy Monitor: trends, attitudes and expectations

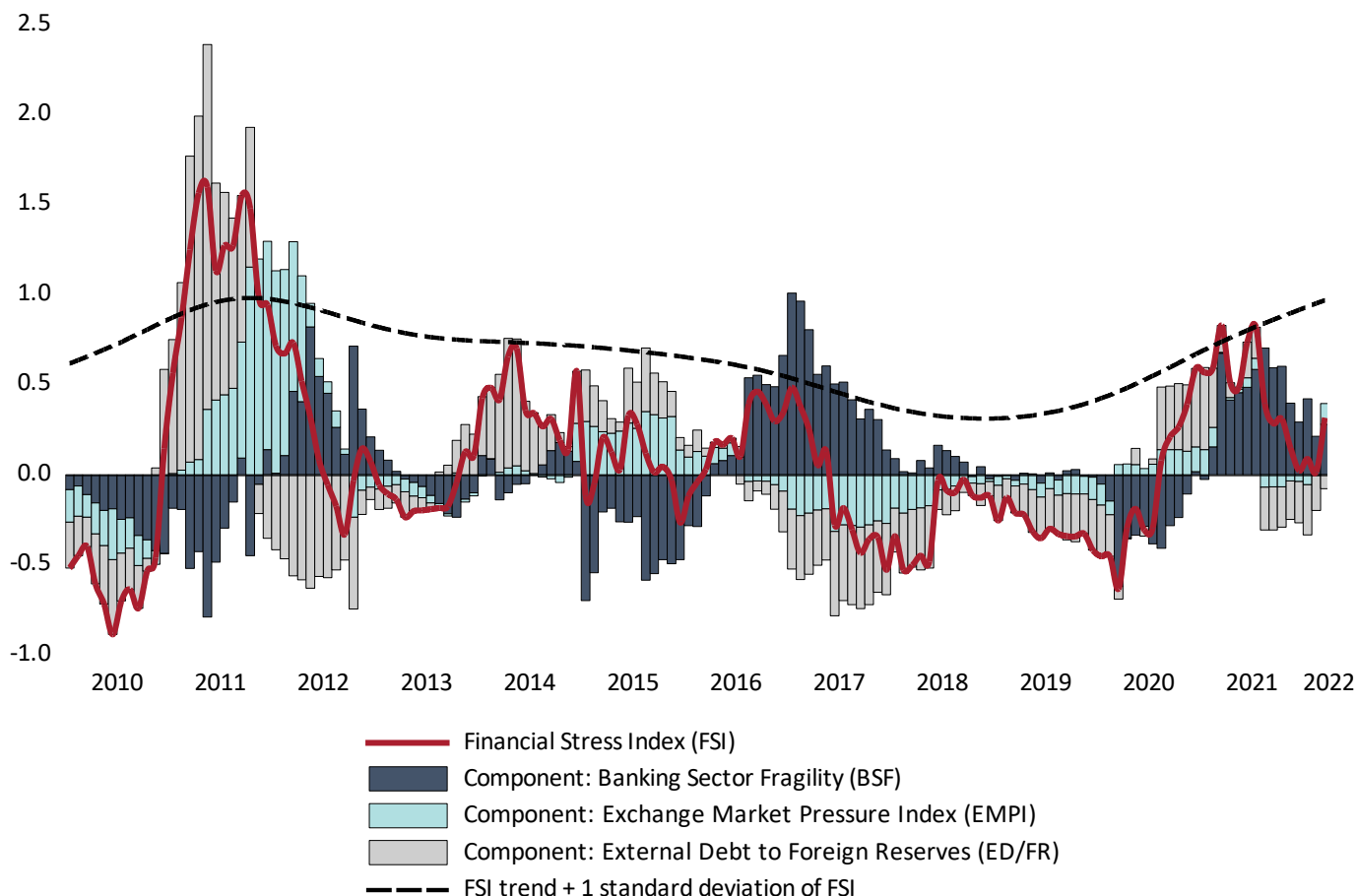


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Financial stability risks growing in Belarus: resilience period ends



Financial Stress Index

The Financial Stability bulletin is an expert analysis of the key vulnerabilities of the Belarusian financial system. The bulletin presents the Financial Stress Index and analyzes the key financial stability indicators. The bulletin identifies negative trends that can form, amplify or signal financial shocks. It should be noted that indicators characterizing the quality of assets of Belarusian banks are beyond the scope of this analysis. This is largely due to doubts whether such data presented in regular statistics correspond to reality. Alternative indicators (e.g., based on IFRS 9) are available irregularly and with a significant delay. Therefore, financial stresses caused by the credit risk of banks can be partially taken or not taken into account in this bulletin.

The Financial Stress Index (FSI) is calculated based on the Principal Component Analysis (PCA) under three components: (1) Banking Sector Fragility (BSF); (2) Exchange Market Pressure Index (EMPI); (3) External Debt to Foreign Reserves (ED/FR), which characterizes the risk associated with external debt). The index is designed in such a way that its standardized mean would be zero. Positive index values indicate an increased financial stress, while negative index values indicate a decreased financial stress. If FSI exceeds a given threshold – the FSI trend (calculated using the Hodrick-Prescott filter) + 1 standard FSI deviation – then this situation is classified as financial instability. Methodological procedures of the current index version are close to those presented by Mazol (2017, <https://beroc.org/upload/iblock/bbc/bbca9d55e12e6504bd5df1ffeca36aa3.pdf>).

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The Financial Stress Index: a shaping growth trend

The Financial Stress Index (FSI) of Belarus slightly decreased in Quarter 1 of 2022 (see Table 1). This is due to the fact that the results of the quarter were largely shaped in the pre-war situation followed by inertia. The key factor that influenced the decrease in the FSI value in Q1 2022 was the improved Banking Sector Fragility (BSF). Nevertheless, the overall index value was in the range of positive values, which characterizes an increased financial stress. The risks associated with Russia's invasion of Ukraine and the expanding sanctions background make it inevitable for the financial system stress to keep elevating in Belarus. The FSI growth potential is primarily associated with the External Debt to Foreign Reserves (ED/FR) component. At the same time, the probability of a trend change and a decreased stability of the banking sector in subsequent periods is extremely high.

The key factor in reducing financial stress is the improvement of the banking sector

Decreased BSF in Q1 2022 vs Q4 2021 was caused by two factors. First, there was a 1.5% increase of lending to the non-financial sector in real terms. This was a consequence of the increased liquidity in the banking system at the beginning of the year, when there were positive macroeconomic impulses in the first two months of the year. Second, foreign financing grew by 0.4% in real terms.

Foreign reserves determine external debt sustainability

The potential for the FSI to increase is primarily driven by a 9.5% decline in Belarus' foreign reserves compared to Q4 2021. Due to this, the FSI component, which characterizes the ability of the State to pay off its external debts in the event of a short-term financial shock (e.g., in case early redemption of the government bonds denominated in foreign currency is requested), led to an increased pressure of the external debt component on the Financial Stress Index.

Table 1. Financial Stress Index

Period	Quarterly average
Q3 2021	0.58
Q3 2021	0.50
Q4 2021	0.16
Q1 2022	0.14

Analysis of indicators: financial stability and bank performance

Capital adequacy indicators in Q1 2022 remained relatively high, but maintained the downward trend formed in Q4 2021. More obviously disturbing changing trends in capitalization value were manifested through a sharp increase in the economic capital of banks with an almost unchanged available capital. The ratio of the first to the second increased from 62.2% to 77.8%. These changes were due to sparkling Belarusian ruble lending against the backdrop of some improvement in the financial standing of the real sector and stable liquidity in the banking system as a whole.

Profitability indicators of the banking sector were declining under the impact of the growing deposit interest rates. Banks needed deposit interest rates to increase in order to incentivize a part of the deposits withdrawn from the banks in the previous periods (2020 through to H1 2020) to get back to the system. Current profitability, although not high, allows banks to stay generally resilient.

Liquidity indicators of banks had multidirectional dynamics in Q1 2022. The liquidity coverage ratio, which had grown in previous quarters, decreased in 2022. The downward momentum was driven by the dynamics of liquidity coverage in the national currency, deterioration of which happened due to the outflow of fixed-term BYN deposits from the banking system and acceleration of the BYN lending. The downward trend in banks' liquidity in the national currency was partially offset by a positive impulse in the foreign currency liquidity coverage ratio: the corresponding ratio increased, and, moreover, it became higher than the regulatory value. The main reason for this was the "shrinkage" of bank loan

portfolios in foreign currency. There was also a significant increase in the share of liquid assets in total assets. The net stable funding ratio slightly decreased by the quarter end.

Table 2. Selected financial performance indicators of banks

Indicators	At quarter end			
	Q2 2021	Q3 2021	Q4 2021	Q1 2022
<i>Capital adequacy indicators</i>				
Regulatory capital to risk-weighted assets	18.3	18.4	17.9	16.9
Tier 1 capital to risk-weighted assets	15.6	15.4	14.8	15.4
<i>Profitability indicators</i>				
Return on assets	2.0	1.9	1.8	1.7
Return on equity	13.5	12.8	12.0	11.4
Interest margin to gross income	14.1	14.1	14.2	12.6
Noninterest expenses to gross income	91.8	91.9	92.3	93.7
<i>Liquidity indicators</i>				
Liquid assets to total assets	16.3	17.0	16.0	17.9
Liquidity coverage ratio, in national currency	82.9	92.7	102.5	89.3
Liquidity coverage ratio, in foreign currency	63.3	68.8	79.8	126.3
Customer deposits to total (noninterbank) loans	79.9	80.6	84.3	83.5
<i>Indicators of sensitivity of the banking sector to foreign exchange risk</i>				
Net open position in foreign exchange to capital	5.3	6.9	4.2	7.3
Foreign-currency-denominated loans to total loans	48.2	47.0	46.9	48.3
Foreign-currency-denominated liabilities to total liabilities	64.0	62.6	62.4	63.9

Sensitivity of the banking sector to the foreign exchange risks was affected by negative impulses in Q1 2022. Banking sector's vulnerability to foreign exchange risks has increased: the relative value of the net open forex position has increased significantly, and there is a trend towards an increase in the forex component, both in assets and liabilities. The foreign exchange component remains at a high level in the balance sheets of banks, which leads to a high exposure to risks associated with the forex rate fluctuations.