

NATIONAL BANK OF THE REPUBLIC OF BELARUS

**FINANCIAL STABILITY
IN THE REPUBLIC OF BELARUS**

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INTRODUCTION

This publication is the first in a series of Financial Stability Reviews that the National Bank of the Republic of Belarus is going to issue on an annual basis. Financial Stability Reviews—unlike regular publications of the National Bank covering trends in the economy and monetary sector, as well as the banking sector and banking supervision development—focus on the features of financial sector risks and will constitute basic publications of the National Bank of the Republic of Belarus on the issue in question.

The purpose of such publications is to inform the institutions concerned and the public about the performance of the National Bank in analyzing and monitoring the financial stability in the Republic of Belarus that is aimed at identifying systemic risks and preventing—at early stages of development—systemic crises in the financial sector of the economy.

Publishing Financial Stability Reviews is expected to promote understanding of the risks faced by financial intermediaries in the economic environment, alerting financial organizations and market participants to a possible collective effect of single actions, and achieving consent on the issue of financial stability and financial infrastructure improvement.

Besides, publications on financial stability provide persons concerned with information on potential risks for the financial stability and the ways of overcoming them, assist financial sector participants in assessing their own risks, and, finally, stimulate informed discussion inside the country on the issues of financial stability.

Publications on financial stability will include sections covering external and internal economic factors of financial stability, status of banks, non-bank financial institutions, financial markets, and their infrastructure in the Republic of Belarus, as well as the results of scientific research dealing with the most topical issues of ensuring financial stability.

The 2007 Financial Stability Review contains five main sections, while the basic results of the analysis are presented in the Executive Summary.

The “External and Internal Macroeconomic Risks” Section describes the trends in the world economy and world financial markets, and their impact on the financial stability of the Republic of Belarus; the main trends in economic development of the Republic of Belarus; the main risk factors determined by developments in foreign trade of the Republic of Belarus, as well as by the volume and structure of foreign financing; national currency stability; analysis of the status of public finances of the Republic of Belarus, and their impact on the financial stability of the Republic of Belarus.

The main trends in the financial condition of enterprises, analysis of the financial capacity of households of the Republic of Belarus, and its impact on operations of the financial sector are presented in the “Non-financial Sector of the Economy” Section.

The “Financial Sector” and “Financial Markets” Sections contain analysis of the main trends and risk profile of the banking sector and sector of non-bank financial organizations of the Republic of Belarus. Particular stress in the publication is placed upon the activity of the banking sector which is determined by its absolute dominance in the structure of the country’s financial sector.

The main risks typical of the payment system of the Republic of Belarus in 2007 and the basic approaches of the National Bank to managing them are described in the “Payment System” Section.

EXECUTIVE SUMMARY

The country's economic development in the period under review was influenced by regional external economic factors, which had both positive and negative impact on the environment for the functioning of the country's financial sector and domestic financial markets. The crises erupting in the world financial markets in 2007 did not significantly affect financial stability in the Republic of Belarus.

The environment for maintaining financial stability in 2007 was created by means of maintaining high rates of domestic economic development against the background of a favorable situation in the regional markets and increased demand for Belarusian exports in the Russian Federation and other trading partners. Financial stability in 2007 was positively influenced by the stability of public finances resulting from—among other things—increased state budget revenues from foreign economic activity.

At the same time, a significant change in the terms of trade with the Russian Federation, a sharp increase in prices for some groups of imported goods, and energy imports in particular, had a number of negative impacts on the country's economy and financial sector.

Increasing devaluation and inflation expectations in early 2007 led to instability in the foreign exchange market, as well as a temporary deterioration in banking sector liquidity in 2007 QI.

Increases in aggregate domestic demand stemming from the growth of households' money incomes and in government spending—together with the impacts of the negative external shock—stimulated creation of prerequisites for a rise in costs and inflation, deterioration in the current account of the balance of payments, growth of external debt, and a heavier burden on the banking sector.

In 2007, the financial sector of the Republic of Belarus was characterized as quite stable, the majority of its stability indicators being within the reasonable range. However, strengthening risk factors can have negative medium-term effects on the stability of financial sector functioning. Poor development of the institutional structure and functional characteristics of the insurance sector and other non-bank financial intermediaries were restraining, to a certain extent, potential development and financial sector stability.

In spite of a number of negative impacts of external shocks, the financial markets were functioning in a relatively stable way. The most significant internal factors adversely affecting financial markets were the imbalances in securities market development and the limited range of instruments used therein, as well as poor development of mechanisms of functioning of financial markets as a whole.

In 2007, sustainable and smooth operation of the payment system was ensured.

CHAPTER 1. EXTERNAL AND INTERNAL MACROECONOMIC RISKS

In 2007, the development of the world economy was characterized by slowing economic growth rates, increasing instability in international financial markets, and mounting long-term investment risks.

In 2007, the dynamics of the aggregate output in the world economy was determined by two main trends: the unfolding financial crisis, which had a negative impact on the rate of growth of developed economies and accelerated growth of emerging market economies.

The worsening situation in the US domestic financial market adversely affected the developed economies of the European Union, Japan, and Canada.

In 2007, world gross domestic product (hereinafter referred to as “GDP”)—calculated according to the methodology used in the IMF World Economic Outlook—grew by 4.9 percent compared to 5 percent in 2006, with the pace of economic growth in the USA, euro area countries, Japan, and Canada slowing. GDP of this group of countries increased by 2.7 percent compared to 3 percent in 2006. The negative impact of decelerating rate of growth of developed economies on the world economy was—to a certain extent—compensated by the growth trends in developing economies, which grew by 7.9 percent in 2007 (Appendix 2).

Continued vigorous growth of world food and energy prices led to an increase in the general level of inflation in the world economy. Price growth was more significant in transition and developing economies which was the result of both the stable growth of aggregate domestic demand and a significant share of food in the baskets of goods and services used to calculate price indices of these countries.

Overall, the unstable situation in the major world financial markets, declining rate of world economic development, and energy price growth predetermined the emergence of uncertainty in relation to the world economy’s medium-term development and an increase in medium- and long-term risks in the financial sphere.

The direct impact of instability in the world financial markets on the economy of the Republic of Belarus was limited, but at the same time the factors associated with regional economic development affected significantly the environment for the functioning of the financial sector of the Republic of Belarus.

Due to the weak integration of the financial sector of the Republic of Belarus into the world financial system, the deterioration of the world financial market situation in 2007 did not have a significant impact on the existing conditions and structure of current account deficit financing in the country’s balance of payments. However, the dynamics of world prices for raw materials, oil, refined oil products, and natural gas, as well as demand for Belarusian exports in the countries-

major trading partners of the Republic of Belarus, notably in the Russian Federation, influenced financial stability of the country's economy significantly during this period.

In 2007, the Republic of Belarus was benefiting from benign foreign economic conditions resulting from the high rates of energy and food price growth, taking advantage, to a large extent, of rising prices in the external markets for a number of major commodities. The average dollar export prices for oil increased by 28.5 percent, for oil products by 12.2 percent, for ferrous metals by 33.8 percent, for trucks by 31.3 percent, for lumber by 47 percent, for potash fertilizers by 21.2 percent, and for nitrogen fertilizers by 57 percent.

In this case the direct effect was ensured by a high demand for the products in the external markets which made it possible to maintain a high level of capacity utilization of domestic enterprises and accordingly raise the industrial output, while the indirect effect was ensured by the increased state budget's tax revenues and payments from foreign economic operations.

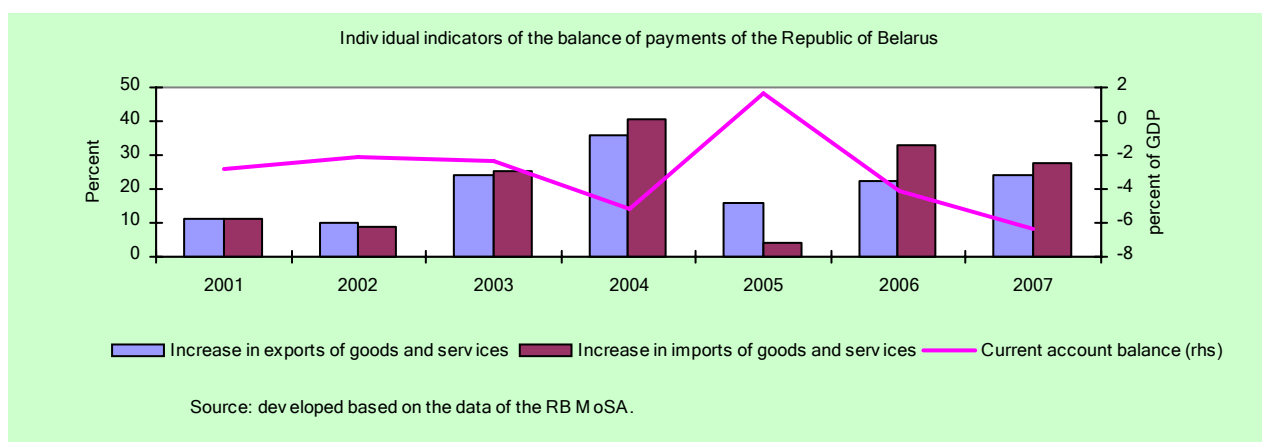
At the same time, a serious negative external shock to the Belarusian economy came in 2007 from the deteriorating terms of trade with the Russian Federation, which became evident in a significant increase in prices for primary energy imports, changes in the terms of oil imports and oil product exports, and import restrictions in the Russian Federation on a number of Belarusian goods in the first half of 2007. The significant increase—by 127.1 percent—in prices for imported intermediate goods, including increases in energy imports by 143.1 percent, gas and oil imports by 2.1 times and 134.6 percent respectively, and increasing export customs duties for oil products led to increased costs and deteriorating financial condition of Belarusian enterprises in those industries, which are major energy consumers.

Overall, from the point of view of financial stability, the internal economic development of the Republic of Belarus in 2007 can be described as stable. At the same time, some macroeconomic risks were increasing due to the growing current account deficit and total external debt, and heavier burden on the banking system.

In 2007, the macroeconomic situation in the Republic of Belarus was characterized by high rates of economic growth; continued business and investment activity in most industries; stable public finances; and increased employment, households' real money incomes, and foreign trade.

The deteriorating terms of trade with the Russian Federation (a significant energy import price increase, changes in the terms of oil imports and oil product exports, restrictions on imports into the Russian Federation of a number of Belarusian goods in the first half of 2007) were, to a large extent, responsible for the increase in the current account deficit and changes in the main characteristics of the balance of payments of the Republic of Belarus.

This had a negative impact on the foreign exchange market situation and financial condition of organizations, led to accelerated inflation and a slowing rate of economic growth, and required the National Bank and the Government of the Republic of Belarus to take adequate measures.



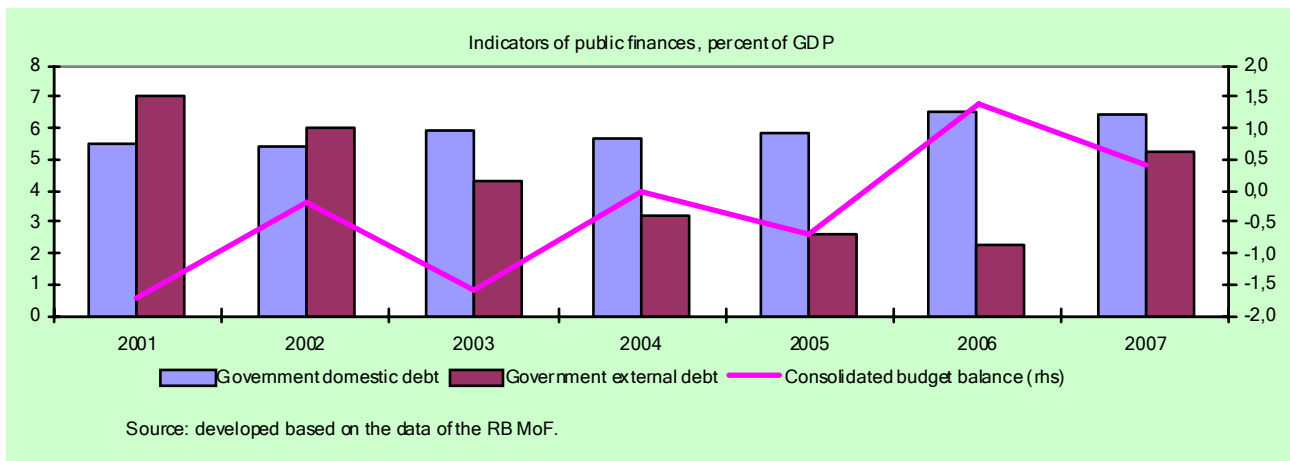
According to preliminary estimates, GDP growth in 2007 was, in comparable prices, 108.2 percent and was predominantly the result of expanding domestic consumer and investment demand. The industrial output volume index increased compared to 2006 by 8.5 percent. Investment into fixed capital increased by 15.1 percent in comparable prices compared with the 2006 level, amounting to 26.3 percent of GDP, a 0.6 percentage point increase on 2006.

Given declining propensity to save and deteriorating financial condition of enterprises of the non-financial sector of the economy, non-residents' funds as well as financial resources of the Government of the Republic of Belarus were an important component of banks' obligations.

In 2007, the Government ran a consolidated budget surplus of 0.4 percent of GDP (in 2006, 1.4 percent of GDP). The overall level of financial resources centralization in the budget (excluding arrears) increased, compared to 2006, by 1.6 percentage points amounting to 50 percent of GDP. The major factor of the increased level of financial resources centralization was a significant increase in tax revenues from foreign economic activity.

The level of tax burden (the ratio of tax revenues and allocations for social insurance to GDP) was 47.3 percent and is the highest in the region and one of the highest in the world which has an adverse effect on the competitiveness of Belarusian enterprises and impedes economic growth.

In 2007, the consolidated budget expenditures reached 47.6 trillion Belarusian rubles, or 49.6 percent of GDP. Compared to 2006, budgetary expenditure was less even by quarters which had a negative impact on business and investment activity of organizations, as well as banking sector liquidity.



In spite of the consolidated budget surplus in 2007, budgetary expenditure increased by 27.5 percent compared to 2006, while nominal GDP grew by 21.2 percent which stimulated an increase in aggregate demand, thereby spurring inflationary processes and increasing the balance of payments' current account deficit.

A 16.8 percent rise in the average export prices in 2007, as well as growth in the volume of exports ensured commodity exports growth by 122.9 percent compared with the 2006 level. At the same time, a significant hike in prices for imported intermediate goods (by 27.1 percent) and growing domestic demand for imports in the economy of the Republic of Belarus owing to increasing money incomes of households, government spending, and a high rate of growth of GDP and fixed capital investment predetermined faster import growth in value terms which, in turn, led to the increased current account deficit in the balance of payments of the Republic of Belarus.

As a result of the worsening situation with energy prices, net imports increased relative to 2006 by USD2.4 billion. There was a stable growth of non-energy imports outstripping production development which was mainly due to the domestic economic factors, such as the need to renovate machinery and equipment, high import intensity of production, and excess demand). As a result, the deficit of foreign trade in goods and services amounted to USD2.7 billion, while the current account deficit was USD2.9 billion, or 6.6 percent of GDP compared to 3.9 percent in 2006.

In 2007, the increased balance-of-payments deficit of the Republic of Belarus was predominantly financed with the funds attracted from non-residents. A relatively low level of total external debt at the beginning of the year, high rates of economic growth, and political stability were conducive to attracting private foreign capital and borrowings at the level of the Government of the Republic of Belarus.

The volume of external borrowings of enterprises of the financial and non-financial sectors actually helped finance the balance of payments deficit. Besides, sales of state property worth USD1.2 billion and the stabilization loan extended by the Government of the Russian Federation in

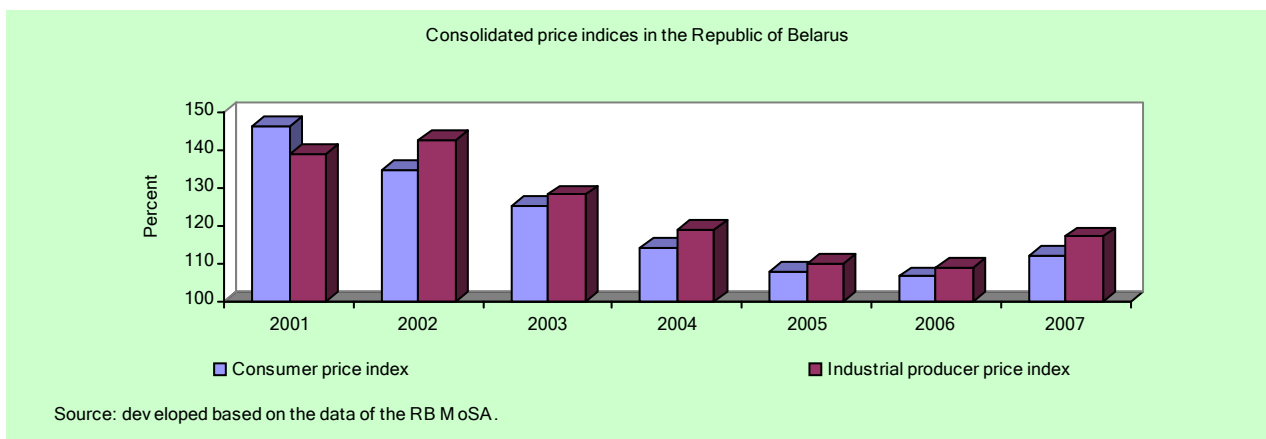
the amount of USD1.5 billion helped generate a surplus of the balance of payment in the amount of USD2.8 billion, or 6.2 percent of GDP.

Increased borrowing led to the growth of total external debt, which by the end of 2007 amounted to USD12.7 billion, rising over the year from 18.4 to 28.4 percent of GDP.

In 2007, the financial condition of enterprises in the non-financial sector was deteriorating as a result of the increase in prices for imported intermediate goods, with administrative price regulation still in place. Expanding stocks of unsold output, decreasing own working capital, and low profitability necessitated wider use of borrowed resources to finance current activity and capital expenditure in the non-financial sector of the economy of the Republic of Belarus. As a result, there was an increase in the rate of growth of enterprises' payables and receivables, and their obligations to banks.

The accelerated growth of energy import prices, as well as import prices for certain groups of goods and services, world food price growth, faster growth of costs in the sector of non-financial enterprises, as well as accelerated growth of aggregate domestic demand, and increased tax burden pushed up inflation in the economy of the Republic of Belarus.

The consumer price index increased in 2007 (December to December) by 12.1 percent, while in 2006 it grew by 6.6 percent. Industrial producer prices rose in 2007 (December to December) by 16.8 percent (in 2006, by 9 percent).



The rise in inflation was caused by a significant increase in production costs mainly due to increased prices for energy and other imported goods, a high level of the tax burden, as well as faster growth of households' money incomes compared with the rate of growth of competitive consumer goods production, growing budget expenditure and lending to individuals, and changing prices in the world food market.

The average dollar import price index in 2007 amounted to 119.8 percent, 3 percentage points higher than the growth of the average dollar export price index, while the nominal effective Belarusian ruble exchange rate declined by 6.8 percent.

The dynamics of consumer prices was also significantly impacted by state regulation of prices and tariffs. For example, in 2007, owing to direct administrative regulation, prices and tariffs in the consumer market increased by 5.7 percent compared to 3.5 percent in 2006, or 47.1 percent of the overall increase in the consumer price index.

CHAPTER 2. NON-FINANCIAL SECTOR OF THE ECONOMY

In 2007, the financial condition of the sector of non-financial enterprises in the Republic of Belarus was characterized by the growth, in real terms, of sales and profits, the reduction in the number of loss-making enterprises, and the increase in balances of economic entities' bank accounts.

Proceeds from sales of products, goods, works, and services of enterprises in 2007 in current prices amounted to 203.7 trillion Belarusian rubles, up by 28 percent on a year earlier, with the average prices in the economy growing by 12.1 percent.

Sales volumes increased owing to the favorable situation in the external market (the rise in the average prices was responsible for a 76 percent increase in the goods export value) and the increase in consumer and investment demand in the domestic market, which, in turn, was the result of a significant growth of households' real incomes (by 14.7 percent) and an increase in all sources of capital investment financing (by 15.1 percent) in comparable prices.

2007 saw growth in real terms of all profit indicators in the economy as a whole and in a number of its main industries. The volume of profits from sales of products increased by 2.7 percent in real terms, profits before tax by 3.1 percent, and net profits by 2.8 percent.

A positive outcome of 2007 was the shrinking number of loss-making and uneconomic enterprises. The share of loss-making enterprises in their total number dropped from 8.3 percent in 2006 to 6.3 percent in 2007, while the share of unprofitable ones from 24.1 to 19.9 percent. The share of uneconomic and marginally profitable enterprises (with profitability from 0 to 5 percent) in 2007 amounted to 47.8 percent¹, while in 2006 it was 50.6 percent.

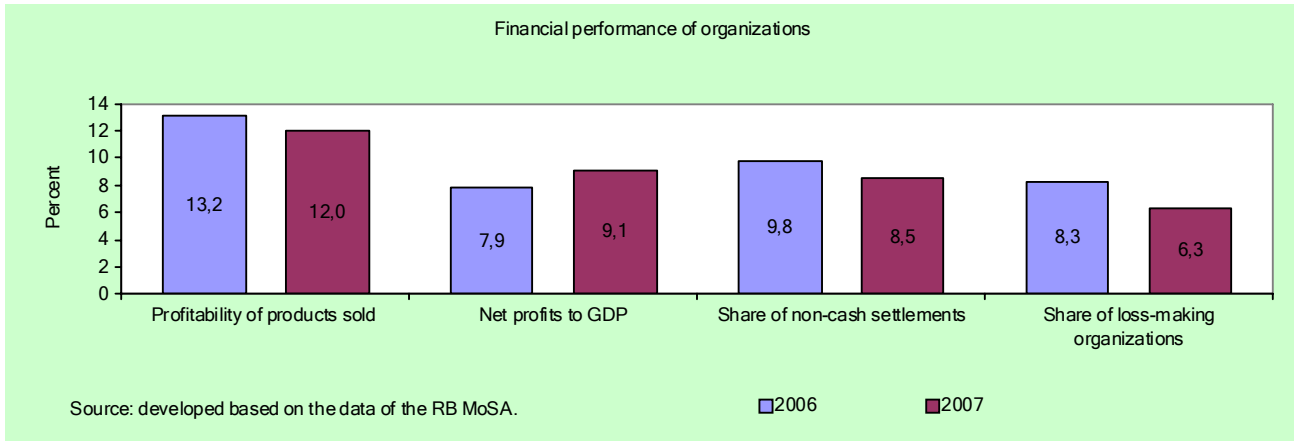
In the whole of 2007, nominal volumes of economic entities' deposits grew faster than in 2006. In the year under review, economic entities' balances of domestic bank accounts increased by 2,779.8 billion Belarusian rubles, or by 41.2 percent in nominal terms and by 26 percent in real terms, amounting to 9,520.3 billion Belarusian rubles as of January 1, 2008. At the same time, during 10 months of 2007 nominal volumes of economic entities' deposits were growing slower than over the same period in 2006. Also, 2007 saw significant fluctuations in the dynamics of deposits by month and by quarter.

At the same time, there were also negative trends, manifesting themselves in a reduced level of profitability of enterprises as a whole, high rates of growth of total arrears, and a low provision of enterprises' with own working capital.

¹ To calculate the number of loss-making enterprises, the measure of net losses is used, to calculate the number of unprofitable and marginally profitable enterprises, measures of profitability of products sold are used.

In 2007, compilation of financial indicators of the sector of non-financial enterprises was characterized by a substantial increase in the average import prices of intermediate goods adversely affecting financial indicators in industries that are principal energy consumers which, in turn, also had a negative effect on major financial indicators in both industry and the economy as a whole.

The significant growth of import prices for intermediate goods and domestic prices for production resources in 2007 caused a decline in sales profitability and worsened the provision of enterprises' with own working capital which has a negative effect on banks' credit risks.



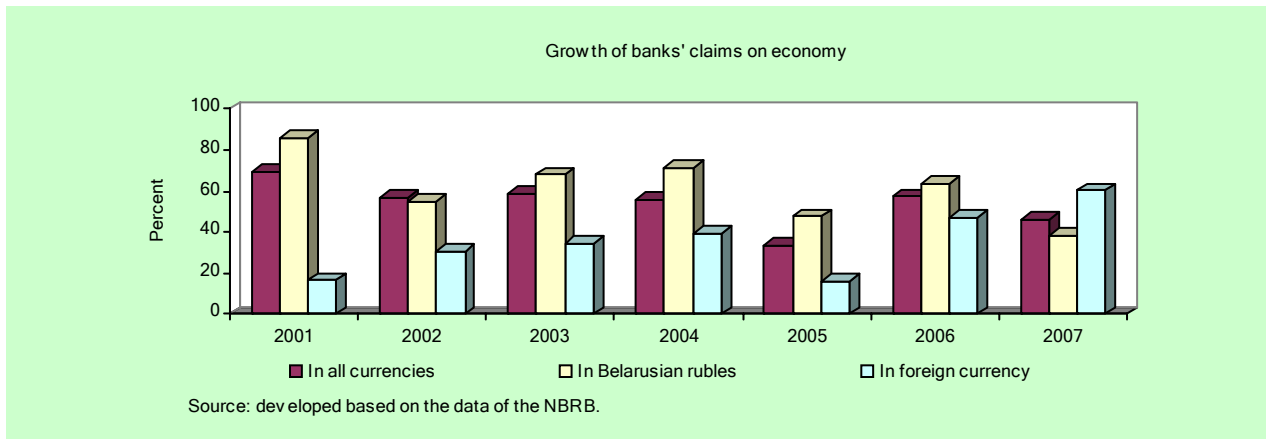
As a result of faster growth of production and sales costs, 2007 saw a decline in sales profitability in those industries that focus on the domestic market, in particular, in communication and construction, as well as in power, fuel, and petrochemical industries. In the economy as a whole, sales profitability fell from 13.2 percent in 2006 to 12 percent in 2007. At the same time, significant export price growth was responsible for profitability growth in most export-oriented industries.

According to the Ministry of Statistics and Analysis of the Republic of Belarus, the working capital in the whole of the economy increased in 2007 by 29.4 percent amounting to 73.2 trillion Belarusian rubles. This notwithstanding, due to the deficit of own funding sources, 90.7 percent of the working capital increase came from debt financing. The level of provision of own working capital at most enterprises is extremely low. Over half of enterprises in the economy as a whole have no own working capital or its provision is below the required level.

Given limited own working capital and declining profitability, high rates of bank lending to organizations and increasing payables were a significant source of financing production and commercial operations and an important factor of increasing money balances of economic entities' accounts.

Banks' claims on economic entities in 2007 increased by 46.1 percent, or by 7 trillion Belarusian rubles. High rates of growth of debt under credit were also accompanied by a significant

increase in the borrowing capacity of the economy², which grew in all major industries and in the economy as a whole from 107.9 percent as of January 1, 2007 to 129.8 percent as of January 1, 2008.



Along with the significant increase in enterprises' debt under credit in 2007, the overall payables and receivables were also growing at a high rate—122.8 and 132.1 percent respectively. Overdue payables increased by 3.8 percent, and overdue receivables by 7.8 percent compared to their decline in 2006 by 7.2 and 9.1 percent respectively.

The indicator of total payables³ which characterizes the volume of borrowed resources to finance current and investment activity gives a clear idea of enterprises' debt. In 2007, total payables of enterprises in the economy as a whole increased by 15.2 trillion Belarusian rubles, or by 34.2 percent, amounting to 59.5 trillion Belarusian rubles in early 2008. Potential risks of declining financial stability of enterprises and the economy were characterized by the worsening ratio of total payables to the proceeds from the sales of products (the source of repayment). In 2007, this indicator grew in all industries, excluding the housing and utilities sector. In most industries it varied at the beginning of 2008 between 2.5 and 4.4 of the average monthly sales proceeds.

Besides, there were significant differences in the level and dynamics of financial indicators of the industries and sub-industries, performance of many enterprises remains low, the bulk of enterprises are in arrears.

In 2007, with economic entities' foreign exchange deposits increasing by 1.3 trillion Belarusian rubles (in the Belarusian ruble equivalent), or by 51.2 percent, banks' claims on economic entities in foreign exchange increased by 3.8 trillion Belarusian rubles, or by 60.4 percent. As a result, the excess of economic entities' debt to banks in foreign exchange over

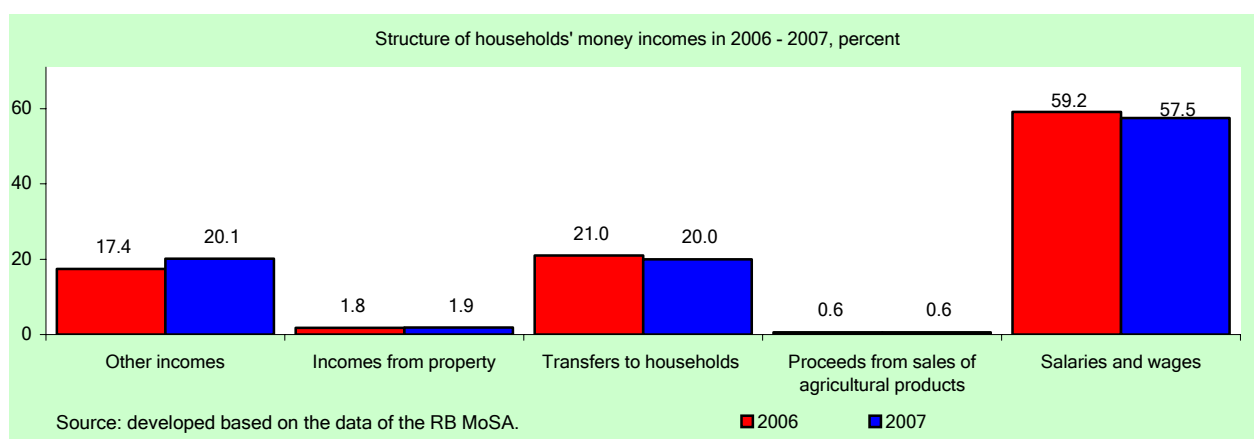
² The ratio of debt under credit to the average monthly proceeds from sales of products, goods, works, and services. On an annualized basis, the indicator of borrowing capacity (the ratio of the average annual amount of debt under credit to the proceeds from annual sales) stood at 7.0 percent in 2006 and 8.8 percent in 2007.

³ Including payables and debt under credit.

their foreign exchange deposits in 2007 increased to 6.2 trillion Belarusian rubles, or by 66.8 percent. The significant growth of this indicator characterizes increasing risks of default on banks' claims on economic entities in foreign exchange.

Vigorous growth of households' money incomes and credit burden boosted consumption, as well as investment, and was accompanied by declining propensity to save and a slowing rate of growth of households' bank deposits.

In 2007, households' wages and money incomes continued to grow, albeit slower than in 2006. Nominal money incomes increased, compared to 2006, by 24.4 percent while consumer prices grew by 8.4 percent (year-on-year). Per capita money incomes reached 492.8 thousand Belarusian rubles per month, 1.8 and 2.7 times the minimum consumer budget and the subsistence budget respectively⁴. Real money incomes⁵ in 2007 increased by 14.7 percent compared to 2006⁶, real disposable incomes by 14.9 percent. The share of households' non-money incomes in GDP in 2007 was 61.4 percent compared to 59.8 percent in 2006.



The indicators of household's income differences are at a relatively low level, increasing slightly in 2007. The resources concentration coefficient (the Gini coefficient) increased from 0.262 in 2006 to 0.274 in 2007⁷. Wage differential by industry persisted. For instance, in the oil refining industry and ferrous metallurgy the average monthly wage in 2007 was approximately twice the average wage in the economy, while in agricultural production 1.7-1.9 times below the average wage.

The debt burden of households—the ratio of debt under credit extended by banks to natural persons to the annual volume of money incomes—increased from 11.6 percent in 2006 to

⁴ At the beginning of 2007, per capita money incomes amounted to 427.1 thousand Belarusian rubles a month, or 158.3 percent of the minimum consumer budget and 246.1 percent of the subsistence budget.

⁵ Incomes adjusted for the consumer price index.

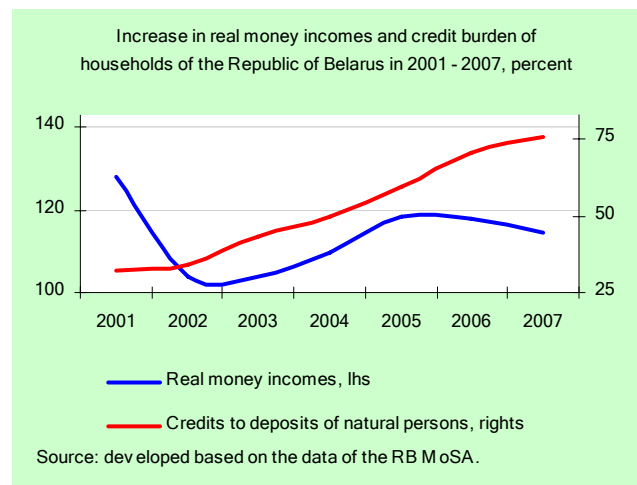
⁶ Households' real money incomes in 2006 increased by 17.3 percent compared to 2005.

⁷ The Gini coefficient estimates the degree of inequality showing how evenly the analyzed indicator is distributed. The value of the Gini coefficient ranges from 0 to 1. In case of complete equality the Gini coefficient is close to zero; the higher the degree of polarization, the closer the coefficient is to one.

13.7 percent in 2007. To a certain degree, the increase in lending to households was caused by the high rates of growth of housing prices in 2007 and softening requirements of banks to their borrowers' solvency.

From the banking point of view, the above-mentioned dynamic expansion of lending to natural persons indicates that the diversification of bank lending in the Republic of Belarus increased. Banks' efforts to expand lending to natural persons are explained by the high yields of these operations, with credit risk being relatively moderate. Fast growth of debt under credit accompanied by a slowdown of real incomes growth and simplified lending procedures may lead to increased risk of banks' credit operations with the category of borrowers under consideration.

One of the substantial changes in households' use of money incomes is the increase in the use of own and borrowed funds to build apartments and houses from 4.4 percent (of the total amount of households' incomes) in 2006 to 6.1 percent in 2007. Households' demand for gold, silver, and platinum bullion, as well as precious stones increased. At the same time, the share of households' cash spent on purchasing



foreign exchange declined. In 2007, households spent USD605.3 million against USD839.1 million in 2006 on net purchases of cash foreign exchange and payment documents in foreign exchange.

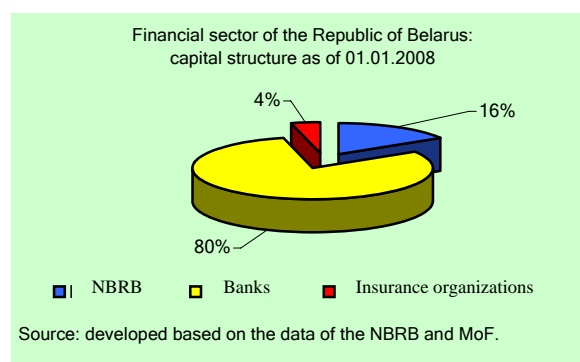
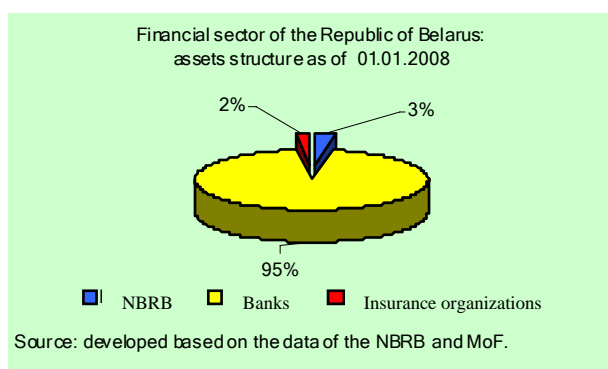
Growth of households' aggregate consumption resulting from the growth of money incomes and improved access to bank credit, as well as growth of households' investments into real estate were responsible for the declining propensity to save in 2007, which was 7.9 percent against 10.1 percent in 2006. Propensity to save, taking into account investment into housing construction, also declined from 14.5 percent (of the total amount of households' incomes) in 2006 to 14 percent in 2007.

Households' deposits in the national and foreign currencies with the banks of the Republic of Belarus grew in 2007 by 20.6 percent in real terms, a 12.3 percentage points decrease on a year earlier, with deposits denominated in Belarusian rubles increasing in real terms by 13.4 percent (in 2006, by 36.8 percent), foreign exchange deposits by USD600 million in the equivalent, or by 51.8 percent (in 2006, by 34.2 percent).

CHAPTER 3. FINANCIAL SECTOR OF THE ECONOMY

The institutional structure of the financial sector of the Republic of Belarus⁸ is characterized by banks' dominance, a high degree of concentration, and a comparatively limited variety of financial instruments used by banks and non-bank financial intermediaries.

In the Republic of Belarus, the financial sector is represented by the National Bank of the Republic of Belarus, banks, and non-bank financial intermediaries, which include insurance organizations⁹.



The ratio of broad money supply to GDP, which characterizes the general level of development of the financial sector and the economy as a whole, was 24.8 percent as of January 1, 2008, increasing, compared to January 1, 2007, by 2.7 percentage points. Aggregate assets of the financial sector¹⁰ accounted for 47 percent of GDP at the beginning of 2008, which is below the level of developed countries (at the same time, it corresponds, on the whole, to the Republic of Belarus' lagging behind them in the level of economic development), with more than 90 percent of aggregate assets belonging to banks, which is an indication that they dominate the domestic financial market of the Republic of Belarus.

⁸ According to the System of National Accounts classification, the financial sector of the economy includes the banking system, which consists of monetary authorities (typically, central banks) and banks; and non-bank financial institutions, such as, for example, insurance and leasing companies; pension, investment, and trust funds; brokerage houses; companies operating in the securities markets; mutual lending companies; etc.

⁹ Leasing companies should be also taken into consideration to guarantee full coverage of the institutional structure of the financial sector of the Republic of Belarus. However, leasing in the Republic of Belarus is not a licensed type of activity; leasing operations are carried out by both financial and non-financial enterprises; there are no balance sheet data on companies involved in leasing activity. Therefore, it is currently impossible to take leasing into account when analyzing structural characteristics of the financial sector of the Republic of Belarus. More detailed information on leasing operations in the Republic of Belarus is presented in Appendix 4.

¹⁰ Assets of the National Bank, banks, and insurance organizations.

Banks perform main functions of financial intermediation in the Republic of Belarus: they provide settlement and cash services to enterprises, organizations and households, accumulate temporarily idle financial resources in the domestic and foreign markets, finance non-financial sectors of the economy, and perform operations in the major domestic and foreign financial markets.

The outstripping development of banking as a predominant type of financial intermediation in the economy of the Republic of Belarus in the absence of institutional entities ensuring the formation of long-term financial resources leads to mismatches between banks' assets and liabilities maturities, increases risks of banking and the country's financial system as a whole, and jeopardizes economic growth rates and well-being of the population. Due to poor development of other segments of the financial sector, banks are able to use only basic financial instruments.

The banking sector of the Republic of Belarus is represented by universal banks, is characterized by a significant concentration and dominance of the state in the ownership structure.

The banking sector of the Republic of Belarus consists of 27 operating banks, of which 23 banks are banks with foreign capital participation, including seven wholly-foreign owned banks. As of January 1, 2008, banks' branch network included 365 branches. As at the end of 2007, six banks were given individual international ratings by Fitch, of which two were also given ratings by Moody's Investors Service.

As of January 1, 2008, five largest banks accounted for 86 percent of assets and 84.2 percent of capital of the banking sector (as at January 1, 2007, 87.0 and 87.3 percent respectively). As of January 1, 2008, the Herfindahl-Hirschman index¹¹ calculated on the basis of data about assets was 0.2265 (a decline of 0.0238 over the year), while the Gini coefficient was 0.796 (a decline of 0.022).

Currently the banking sector of the Republic of Belarus is dominated by banks with the prevailing state stake. As of January 1, 2008, the share of government agencies and state entities in the total authorized capital of banks was 86.3 percent, the share of non-residents 9.8 percent, and the share of other investors 3.9 percent.

Structural indicators of profitability improved, and banks' return on capital increased.

Investments into the banking sector together with profits earned by banks became the main source used by banks to augment their capital. The capital of the banking sector grew in 2007 by 28.6 percent (in 2006, by 27.9 percent) amounting, as of January 1, 2008, to 6.7 trillion Belarusian

¹¹ The Herfindahl-Hirschman index reflects the degree of concentration of the indicator. Its value ranges from 0 to 1. Value 0 corresponds to minimum concentration, less than 0.10 to a low level of concentration, from 0.10 to 0.18 to an average level of concentration, and over 0.18 to a high level of concentration.

rubles, with the rates of banking sector capitalization noticeably lagging behind the scope of banks' assets operation expansion.

Total profits of the banking sector in 2007 amounted to 602 billion Belarusian rubles, increasing by 46.5 percent compared to 2006. Operating expenses were 1,594 billion Belarusian rubles, of which staff costs 707 billion Belarusian rubles. Taking into account net transfers to reserves in the amount of 129 billion Belarusian rubles, profits of the banking sector before tax amounted to 792 billion Belarusian rubles.

In the whole of 2007, banks' return on assets (before tax) was 2.30 percent, compared with 2.39 percent in 2006; and banks' return on capital (before tax) was 13.80 and 12.86 percent respectively. Such an insignificant decline in return on assets in 2007 was due to the growth of assets outstripping that of profits: while the average annual assets of the banking sector grew by 48 percent, net profit before tax increased by 42.3 percent.

Increasing profit margin, risk level, and financial leverage were beneficial to the return on capital. At the same time, declining return on risk-weighted assets acted as a deterrent¹².

The ratio of interest margin to gross income continued increasing from 38.91 percent in 2006 to 40.66 percent in 2007. One of the factors determining growth of this indicator was an increase in banks' lending operations. Besides, 2007 saw a decline in the ratio of non-interest expenses to gross income and in the share of expenses on personnel in non-interest expenses. In the whole of 2007, they amounted to 73.91 and 31.51 percent respectively, (in 2006, 74.85 and 33.23 percent).

The insurance sector of the Republic of Belarus is characterized by relatively small volumes of capital and assets, a high degree of concentration, predominantly state ownership and preferential treatment of state-controlled insurance organizations, and lack of proper competition in the market of insurance services.

As of January 1, 2008, there were 23 insurance organizations in the insurance market of the Republic of Belarus, of which 8 with the state share in their authorized capital, 9 with foreign capital participation, and 4 organizations were offering voluntary life and additional pension insurance. As at January 1, 2008, insurance companies' own capital amounted to 305.6 billion Belarusian rubles, or 0.3 percent of GDP, increasing over the year by 58 percent.

Authorized capital of insurance organizations was 174.9 billion Belarusian rubles as of January 1, 2008, or 57.2 percent of own capital, increasing in 2007 by 72 percent predominantly

¹² 4 components can be identified in the structure of return on capital: profit margin, return on risk-weighted assets, risk level, and financial leverage. Profit margin is the ratio of profits (before tax) to net incomes from banking activity; return on risk-weighted assets is the ratio of net incomes from banking activity to risk-weighted assets; risk level is the ratio of risk-weighted assets to total assets; and financial leverage is the ratio of assets to capital.

owing to state investments. The insurance sector's assets amounted to 836.9 billion Belarusian rubles as of January 1, 2008, or 0.9 percent of GDP.

The Herfindahl-Hirschman index for the insurance sector calculated based on the indicator of insurance premiums including re-insurance stood at 0.35 in 2007, while the Gini coefficient calculated based on the same indicator was 0.87 which indicates a high level of concentration of the insurance market in the Republic of Belarus.

In 2007, preferential treatment of state-controlled insurance organizations¹³, restrictions on activity of insurance organizations with foreign capital¹⁴, as well as the state monopoly on intermediation services in the re-insurance market reduced the ability of the insurance market to develop dynamically and to raise capitalization of insurance organizations, the market value and investment attractiveness of Belarusian insurance organizations for investors, above all non-residents, and led to a rise in prices of insurance services in the Republic of Belarus. Given anticipated growth of the extent of insurance and insurance coverage, all this creates preconditions for declining sustainability of the insurance sector in the medium term.

In 2007, the insurance premiums received by Belarusian insurance organizations under direct insurance and co-insurance increased by 20.5 percent, amounting to 666.1 billion Belarusian rubles, or 0.7 percent of GDP. The share of voluntary types of insurance in the total amount of insurance premiums received was 41.3 percent (in 2006, 37.2 percent). In the structure of voluntary insurance premiums the share of personal insurance was 21.6 percent, property insurance 69.5 percent, and liability insurance 8.9 percent.

The share of compulsory types of insurance in the total amount of premiums was 58.7 percent (in 2006, 62.8 percent), of which personal insurance 43.6 percent of the amount of collected compulsory insurance premiums, property insurance 4.7 percent, and liability insurance 51.7 percent. The insurance money and insurance coverage paid out in the country as a whole in 2007 amounted to 344.4 billion Belarusian rubles. In the structure of insurance payments the share of voluntary insurance was 35.3 percent, and compulsory insurance 64.7 percent. Insurance payments accounted for 51.7 percent of all insurance premiums received.

Unprofitability (the ratio of insurance payments to insurance premiums received) stood at 0.52 in 2007 and practically remained unchanged compared to 2006¹⁵.

In 2007, all insurance organizations attained positive financial results (in 2006, 5 insurance companies were in the red) totaling 56.4 billion Belarusian rubles in the sector as a whole. The ratio

¹³ Preserving their monopoly rights to engage in compulsory types of insurance.

¹⁴ Insurance organizations with a share of foreign capital exceeding 20 percent had no opportunity to engage in compulsory insurance, life insurance (cumulative types), insurance of valuable interests of state-owned enterprises and organizations, and some other types of insurance.

¹⁵ For voluntary insurance the level of unprofitability declined in 2007 from 0.50 to 0.44, while for mandatory insurance it increased from 0.55 to 0.57.

of insurance companies' financials to the average annual amount of their own capital in 2007 declined by 4.6 percentage points remaining, however, at a high level (23.6 percent).

In 2007, one of the insurance organizations was given financial stability rating B by Fitch and has a stable outlook.

Direct investment of financial institutions into other segments of the financial sector is currently insignificant. The risk of contamination of banks and insurance organizations through the channel of mutual participation in authorized capitals seems to be quite low.

Banks' investments into the authorized capital of insurance organizations were about 2.2 billion Belarusian rubles as of January 1, 2008, which is equivalent to 0.05 percent of the regulatory capital of the banking sector. The share of banks' participation in the total authorized capital of insurance organizations amounted to 1.2 percent. Banks' investments into authorized capital of organizations specializing in leasing operations amounted, according to estimates, to 3.8 billion Belarusian rubles as of January 1, 2008, which is equivalent to 0.06 percent of the regulatory capital of the banking sector. Investments of insurance organizations into the authorized capital of other deposit corporations, according to the National Bank, amounted to 0.6 billion Belarusian rubles, which is equivalent to 0.2 percent of own capital of the insurance sector. The share of insurance organizations' participation in the total authorized capital of banks amounted to 0.01 percent.

Overall, at the end of 2007 the National Bank singled out—when supervising banking activity on a consolidated basis—11 banks, which were head organizations of bank groups (holding companies). The banks were dominant participants of these groups (holding companies), whilst the share of other participants in total assets of the groups (holding companies) was insignificant.

The major risks in the banking sector in 2007 were associated with high rates of assets growth, which significantly exceeded the rate of economic growth of the Republic of Belarus.

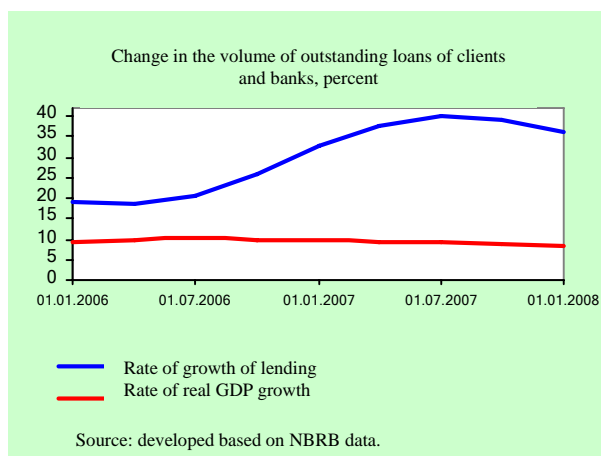
The rate of growth of banks' lending operations continued increasing: the banking sector's assets exposed to credit risk grew from 45.7 percent in 2006 to 47.5 percent in 2007. Due to the simultaneous increase of the share of lending operations with a high level of risk¹⁶, credit risk-weighted assets (weighted to calculate regulatory capital adequacy) increased in 2007 by 68.3 percent compared to 42.1 percent in 2006.

As of January 1, 2008, in the structure of assets the share of banks' claims on non-residents of the Republic of Belarus was 6.4 percent of all assets of the banking sector (as of January 1, 2007, 3.2 percent). In the structure of the banking sector's assets exposed to credit risk as of January 1,

¹⁶ Assets classified under Groups VI and VII according to credit risk to calculate regulatory capital adequacy.

2008 the largest share was accounted for by legal entities' debt under credit (66.8 percent, a 0.5 percentage point reduction), credit to natural persons (23.6 percent, reduction by 0.4 percentage points), and deposits placed with banks (9.6 percent, a 1.3 percentage point increase).

As a result of high demand for credit resources on the part of banks' clients, the level of banks' exposure to credit risk¹⁷ in the banking sector as a whole increased from 59.7 percent at the beginning of 2007 to 70 percent at the beginning of 2008. Along with this, banks became more dependent on the sustainability of their largest borrowers.



For example, the ratio of large open positions to the regulatory capital in the whole of 2007 increased by 35.4 percentage points, amounting to 101.4 percent as of January 1, 2008 (although this indicator continues to be substantially below the ceiling in the amount of six times the size of regulatory capital). Moreover, the fact that the rates of the generation of debt under credit in the banking sector were outstripping those of economic growth also points to a growing dependence of sustainable functioning of the banking sector on stable operation of the whole non-financial sector of the economy.

During 2007, the rate of increase of the average annual volume of debt under credit adjusted for the GDP deflator grew from 32.5 to 36.2 percent, while the GDP increase in comparable prices dropped from 10.0 to 8.2 percent. At the same time, it should be noted that starting from August 2007, the rate of increase in the average annual volume of debt under credit was slowing.

In spite of high rates of growth of assets subject to credit risk, the amount of problem assets of the banking sector in 2007 remained virtually unchanged.

High rates of growth of assets subject to credit risk and an insignificant increase in problem assets¹⁸ were responsible for a further improvement in the quality of the banking sector's assets in 2007. The share of problem assets in assets subject to credit risk declined from 2.83 percent as of January 1, 2007 to 1.92 percent as of January 1, 2008. At the beginning of 2008, problem assets amounted to 649 billion Belarusian rubles, remaining practically unchanged during 2007. Over 94 percent in their structure are problem assets extended to legal persons.

Changes in the preferences of natural and legal persons as to the currency of savings and borrowing and attraction by banks of significant volumes of non-residents' resources led to an

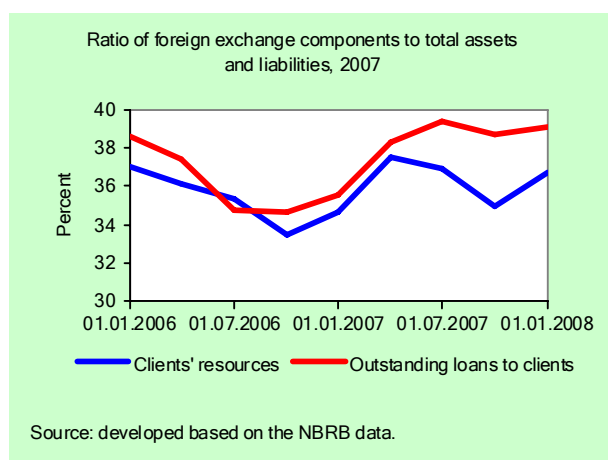
¹⁷ The ratio of risk-weighted assets (weighted to calculate regulatory capital adequacy) to assets.

¹⁸ Assets subject to credit risk and classified under Groups III, IV, and V to create special provisions.

increase in the share of foreign exchange components in the banking sector's assets and liabilities, the banking sector becoming more vulnerable to likely negative developments in the country's foreign exchange market.

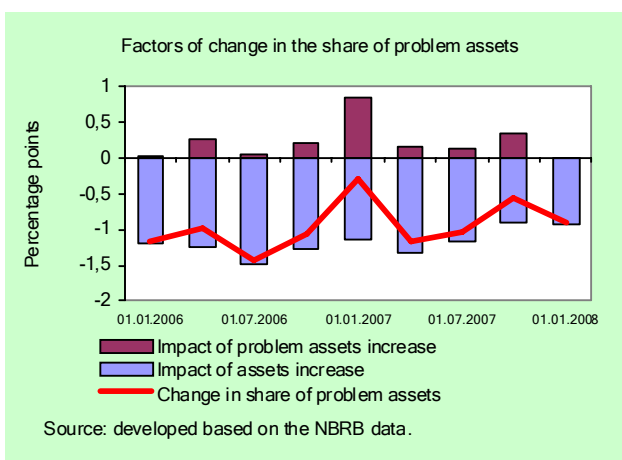
During 2007, banks' indebtedness to non-residents grew by 2.4 trillion Belarusian rubles (in the equivalent); while in 2006 they increased by 1.1 trillion Belarusian rubles. The rate of their increase was two times the rate of domestic borrowing which led to the growth of the share of non-residents' resources in the total volume of the banking sector's liabilities to 12.8 percent. The resources attracted by banks

in 2007 from non-residents were predominantly short-term (subject to repayment during 12 months), while credit extended by banks to their clients in foreign exchange has longer maturities. Given the unstable situation in international financial markets, such practice poses increased risks to the banking sector.



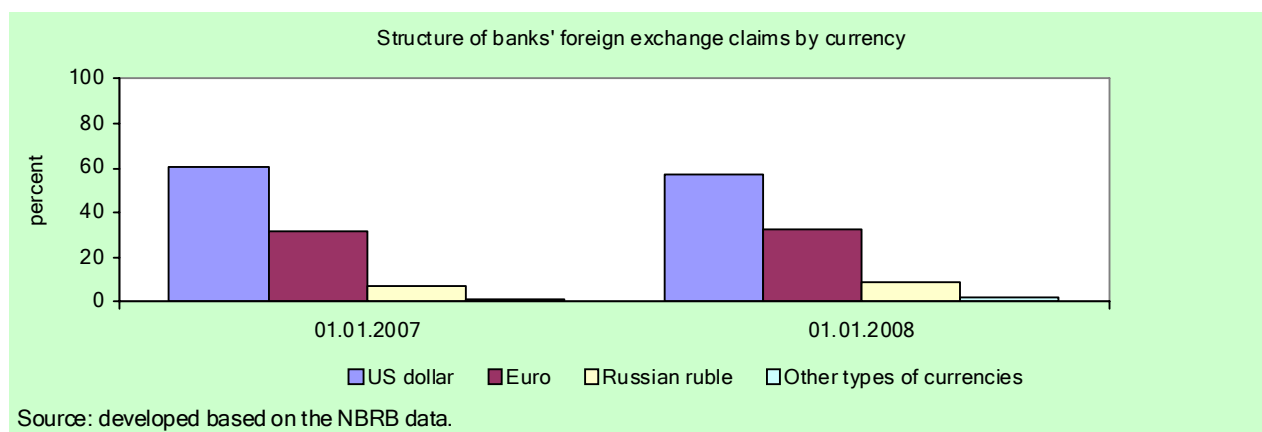
in foreign exchange subject to credit risk grew by 25.3 percent, while 2007 saw a 65.6 percent increase. Similar changes occurred with clients' funds placed with banks. In 2006, their volume in Belarusian rubles increased by 46.4 percent, in 2007 by 38.6 percent, in foreign exchange by 32.4 and 51.6 percent respectively.

The majority of foreign exchange claims of the banking sector are financial instruments denominated in US dollars. As of January 1, 2008, their share in the total volume of claims amounted to 57.0 percent, declining over the year by 3.2 percentage points. The share of claims in euros increased insignificantly, reaching 32.3 percent at the beginning of 2008. There was a



The share of clients' foreign exchange debt under credit in the total amount of their debt under credit increased by 3.6 percentage points in 2007, while the share of clients' foreign exchange funds in all attracted deposits increased by 2.1 percentage points. Where in 2006 assets in Belarusian rubles subject to credit risk grew by 61.4 percent, in 2007 they increased by 36.7 percent. And vice versa, in 2006 assets in

considerable increase in the share of the Russian ruble, from 7.1 to 8.9 percent, and other currencies too (from 0.8 to 1.8 percent respectively).



The total open position in foreign exchange relative to banks' regulatory capital in 2007 was within the limits of the established requirement for individual banks (no more than 20 percent) amounting to 4.8 percent as of January 1, 2008, which points to a sufficient "margin of safety" of the banking sector in case of sharp fluctuations of exchange rates. At the same time, growing share of foreign exchange credit in the credit portfolio of the banking system of the Republic of Belarus is an indication of increasing indirect foreign exchange risks for banks.

In spite of the existing maturity mismatch between banks' assets and liabilities, the improved maturity structure of liabilities of the banking sector in 2007 enabled liquidity risk to be maintained at a reasonable level.

In the structure of assets¹⁹ by maturity, the long-term component (over 1 year) continued growing, reaching 50 percent by January 1, 2008 (49.1 percent in the previous year). Along with this, the share of the most liquid assets (up to 1 month) declined from 10.7 percent at the beginning of 2007 to 9.2 percent at the end of 2007. The share of liabilities²⁰ with maturities over 1 year amounted to 40.1 percent as of January 1, 2008 compared to 28.2 percent as of January 1, 2007.

As a result of such developments in the structure of the banking sector's assets and liabilities in 2007, the mismatch between assets and liabilities with maturities over 12 months remained practically unchanged—6,158 billion Belarusian rubles (6,155 billion Belarusian rubles as of January 1, 2007).

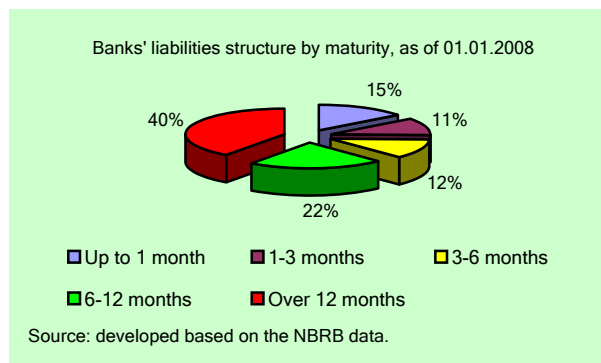
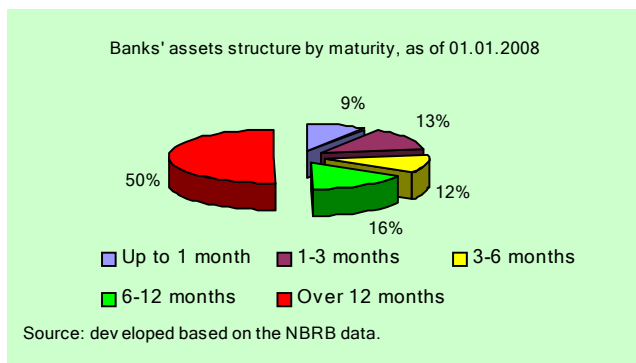
In 2007, banking sector liquidity indicators were within the following range:

21–26 percent for the ratio of liquid assets to total assets, the requirement for an individual bank being at least 20 percent;

¹⁹ Assets with a specific maturity date.

²⁰ Liabilities with a specific maturity date.

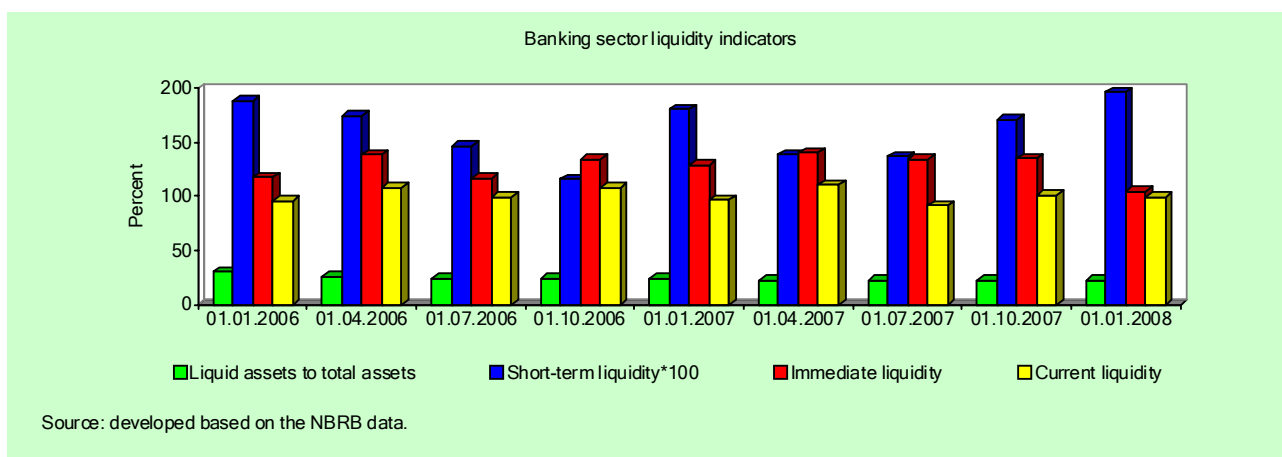
1.33–1.97 for the ratio of actual liquidity to required liquidity (short-term liquidity), the requirement for an individual bank being at least 1;



104–152 percent for the ratio of demand assets to demand liabilities (instantaneous liquidity), the requirement for an individual bank being at least 20 percent; and

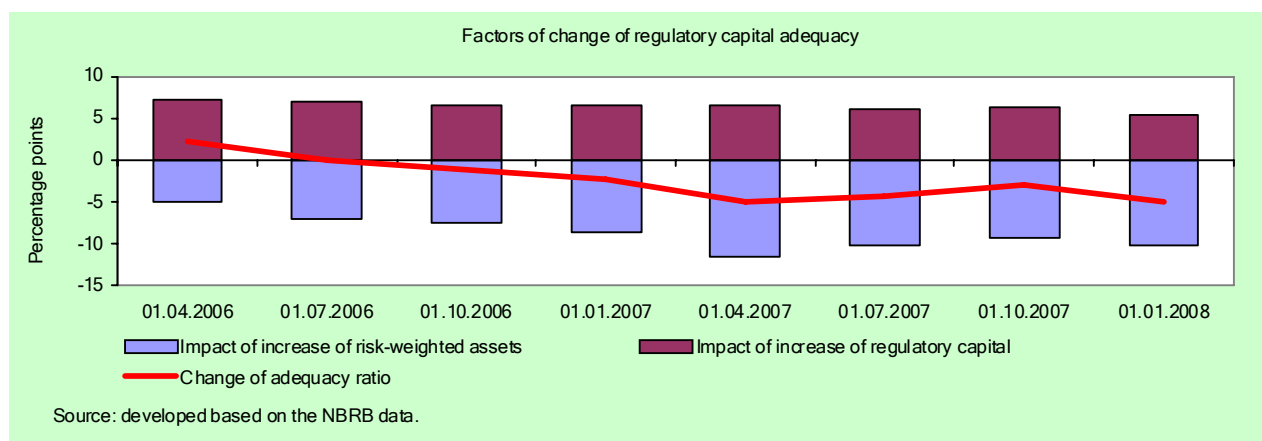
92–112 percent for the ratio of current assets to current liabilities (current liquidity), the requirement for an individual bank being at least 70 percent.

Banks' capital adequacy ratios continued going down which suggests declining ability to cover growing risks with capital.



The regulatory capital adequacy ratio in 2007 declined by 5.1 percentage points (in 2006, by 2.3 percentage points), amounting to 19.3 percent as of January 1, 2008, the requirement for an individual bank being 8 percent. The core capital adequacy ratio in 2007 declined from 17.4 to 14 percent as of January 1, 2008 (the requirement for an individual bank being 4 percent), and the ratio of capital to assets of the banking sector calculated based on banks' balance sheet data fell from 17.8 to 15.9 percent.

The banking sector's capital adequacy ratios declined mainly due to their reduction at banks with a dominant state share in their capital. For example, the regulatory capital adequacy ratio of this category of banks fell by 6.2 percentage points, while that of banks with a dominant share of non-residents of the Republic of Belarus in their capital declined by 1.6 percentage points, and that of other (local private) banks by 0.2 percentage points.



The capital adequacy ratios were declining because capital growth rates were falling behind the rates of growth of assets (notably credits) in the banking sector. Where risk-weighted assets grew in 2007 by 60 percent, core capital increased by 25.1 percent, and regulatory capital by 26.7 percent.

Faster growth of regulatory capital compared with core capital led in 2007 to the deterioration in capital quality. The ratio of additional capital to core capital as of January 1, 2008 amounted to 25.1 percent compared to 23.4 percent as of January 1, 2007.

To assess the vulnerability of the banking sector of the Republic of Belarus in 2007 to various unfavorable events caused by macroeconomic developments, stress testing by main types of risks inherent in banking activity was ongoing.

Overall, stress testing showed that the banking sector is quite vulnerable to a hypothetical decline in the quality of its credit portfolio. In case of significant deterioration in the financial condition of borrowers and growth of overdue credit, banks would face losses considerably exceeding the previous year's profits. The impact would be especially strong if indirect foreign exchange risk materializes, where as a result of sharp Belarusian ruble depreciation many clients would default on their foreign exchange obligations to banks. The direct impact of the Belarusian ruble depreciation would be insignificant.

Besides, in spite of the 2007 excess liquidity, the banking sector remained vulnerable to clients' run on banks. More detailed information on the methodology and results of stress testing is presented in Appendix 1.

CHAPTER 4. FINANCIAL MARKETS

In 2007, the money market conditions of the Republic of Belarus were under the impact of external factors associated with changes in the terms of trade with the Russian Federation and inflow of non-residents' funds into the banking sector.

Increasing inflation and devaluation expectations of enterprises and households of the Republic of Belarus in late 2006–early 2007 resulting from emerging external shocks had a number of negative effects on the monetary sector of the country, including, in particular, growing net demand for foreign exchange, declining gold and foreign exchange reserves, growing demand for credit in domestic and foreign currency, and changing currency structure of banks' assets and liabilities.

Growing speculative demand for instruments in foreign exchange and outflow of household deposits in 2007 QI led to liquidity shortage in the banking sector which caused a significant increase in interest rates in the money market. In this situation the National Bank took measures to tighten monetary policy. In particular, in January 2007 interest rates on permanently available instruments and bilateral transactions forming the upper end of the range of the interest rate on interbank credit were raised from 16 to 20 percent per annum, and in February the refinance rate was raised from 10 to 11 percent per annum.

These measures, combined with limited maintenance of banks' liquidity, made it possible to keep interest rates of the interbank market at a higher level during 2007 QI. The average weighted interest rate on intraday interbank credit was at the level of 13.4 percent per annum in January 2007, 19.8 percent per annum in February, and 19.4 percent per annum in March.

Monetary policy tightening in early 2007 was conducive to the inflow of private foreign capital in the subsequent months. Banks were actively attracting non-residents' resources, basically of short-term nature. All this helped to close the gap between demand and supply in the domestic foreign exchange market caused by the increased current account deficit of the balance of payments. Eliminating negative expectations stimulated capital inflow of the financial account which was conducive to keeping the movement of the national currency exchange rate within the target range and building up gold and foreign exchange reserves to the level ensuring the implementation of a more flexible exchange rate policy. Confidence in the national currency savings was restored.

In QII-QIV, the situation in the ruble interbank market was developing against the background of excess liquidity in the banking sector. That period was characterized by a decline in the level of interest rates which was caused by the significant volume of idle resources in the

banking sector. The National Bank was seeking to withdraw banks' excess liquidity and maintain interest rate on intraday interbank credit at the level close to the refinancing rate.

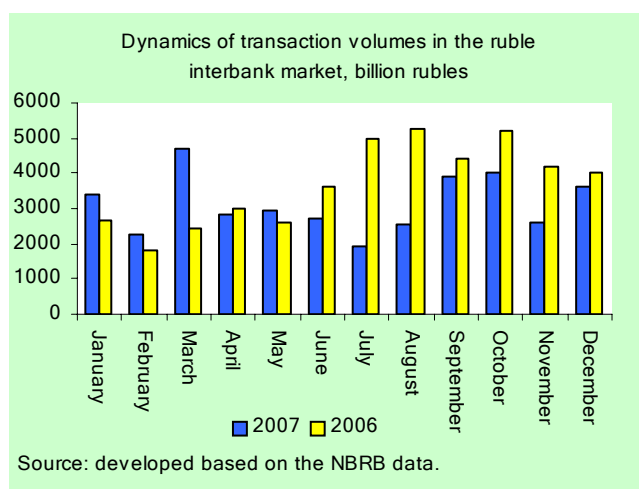
Thus, in the whole of 2007 the National Bank ensured efficient functioning of the market of interbank credit denominated in the national currency and redistribution by the same of resources in the volumes sufficient for smooth settlements. The ruble interbank market did not experience significant changes in 2007 compared to the previous year in terms of either duration of transactions (over 80 percent of which are one-day transactions)

or volumes of operations (37.6 trillion Belarusian rubles in 2007 compared to 44.2 trillion Belarusian rubles in 2006). A slight decline in its capacity is explained by the fact that the period of extensive use of interbank credit, when the volume of transactions in 2007 exceeded the volume of transactions within the same period of the previous year, was limited to Q1. But much of 2007 was characterized by excess liquidity which reduced demand for interbank resources compared to 2006.

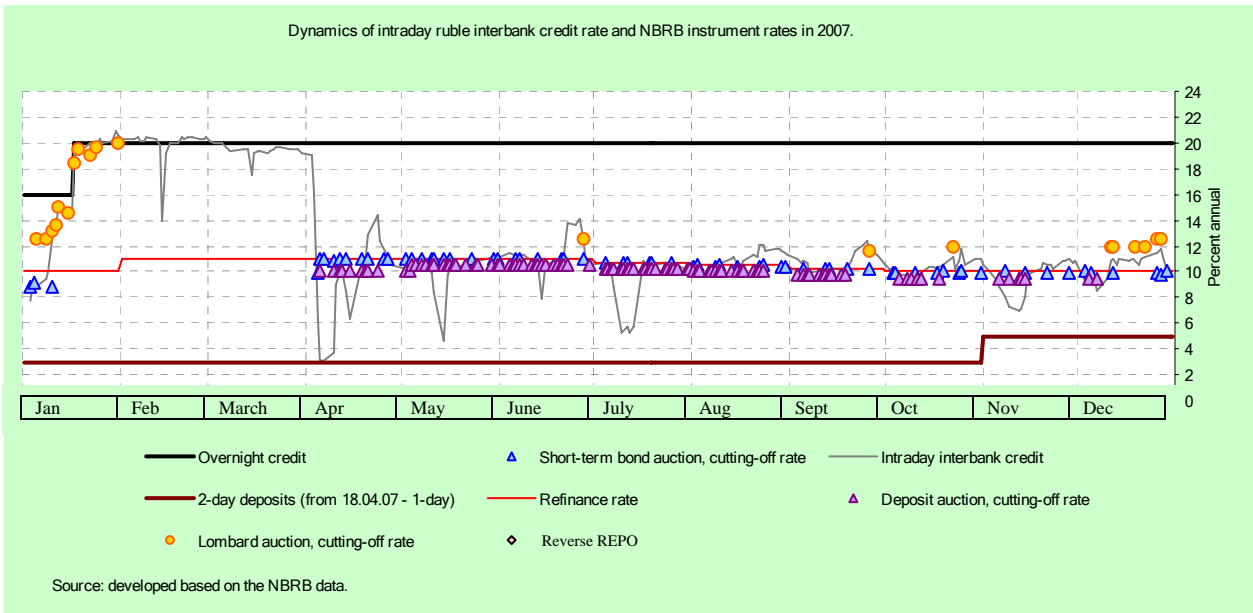
Credit risk (risk that a borrower will default on a payment due) in this segment of the market remained low in 2007. The share of problem debts in the total volume of the market of interbank credit denominated in the national currency was close to zero. Active presence of the National Bank in the market and improved instruments of liquidity regulation and prudential supervision were conducive to eliminating the threat of increased credit risk, liquidity risk, and interest rate risk, which the remaining asymmetry of the structure of the ruble interbank market was fraught with (two largest banks accounted for over 76 percent of demand, while in the supply of resources the share of the largest lender did not exceed 12.5 percent). The risk level also declined thanks to the development of the secured segment of the interbank market—REPO transactions, for which the average daily outstanding amount in 2007 was over 95 billion Belarusian rubles (nearly 2.6 times the growth compared to 2006).

Interest rate risk and liquidity risk in the ruble interbank market in 2007 had clear-cut dynamics resulting from the response to the external economic shock: they grew in Q1 and then declined and remained at a low level.

Reduced supply of resources and raised interest rates in the market in early 2007, the need to tighten monetary policy expressed in the widening interest rate band owing to an increase in its upper end, and reduced support provided by the National Bank through auctions raised banks' risks of unfavorable changes in the interest rate and impossibility to make deals on reasonable terms.

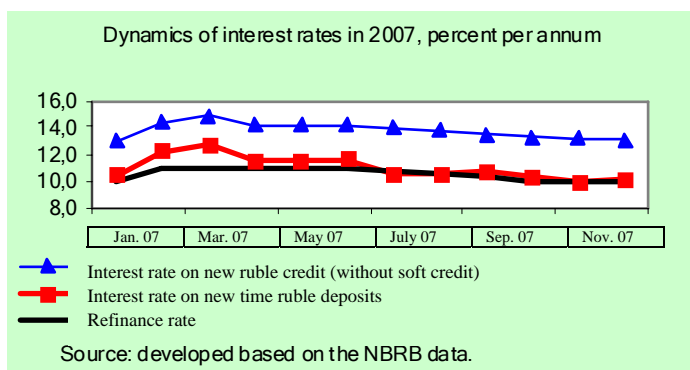


However, it should be noted that having implemented a set of measures, which stimulated banks' borrowings abroad and offering more attractive terms for time deposits domestically, the National Bank efficiently controlled the level of risks keeping them within the established limits. For example, owing to timely support of the banking system's liquidity by means of permanently available instruments and bilateral operations at a fixed rate, the National Bank prevented the interbank market rate from significantly exceeding the upper end of the interest rate band and payment crises from occurring.



Upon the stabilization of market situation in 2007 QII, albeit the interest rate band was not narrowed, the interbank market rate was approaching the target, i.e. the refinance rate, thanks to the National Bank's auction operations of liquidity withdrawal and provision. Thus, the volatility of the interbank resources cost was significantly reduced. The average monthly range of fluctuations of interest rates on intraday ruble interbank credit dropped from 7.4 percentage points in 2007 QI to 4.2 percentage points in May-December.

The intraday interest rate spread also declined significantly which points to the leveling out of conditions for market participants and reduced level of interest rate and liquidity risks.



The interest rate on new ruble time deposits increased from 9.7 percent per annum in December 2006 to 12.7 percent per annum in March 2007, easing back gradually to 10.1 percent per annum subsequently. In QI, interest rates on new time deposits of legal and

natural persons tended to increase²¹, and beginning in QII they moved in opposite directions²². Growth of interest rates on deposits of natural persons was stemming from the need to keep them at a positive level in real terms because of higher inflation rates in 2007 compared to 2006²³.

The yield of new time foreign exchange deposits in 2007 was within the range of 6.5-7.5 percent per annum remaining, on the whole, unchanged compared to 2006.

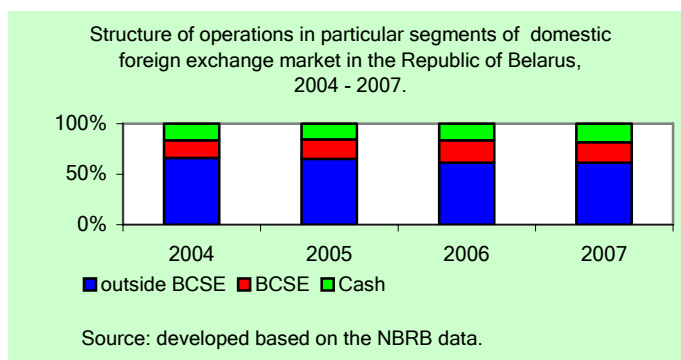
In 2007, the share of the foreign exchange component in credits and deposits increased (growth of currency replacement) which was a significant risk factor in respect of financial stability in the medium term.

Growing interest rates on ruble credits, especially in 2007 QI, against the background of inflow of non-residents' funds into the banking sector quickened the pace of lending in foreign exchange. The interest rate on new ruble credits²⁴ increased from 12.8 percent per annum in December 2006 to 14.9 percent per annum in March 2007, thereafter declining gradually to 13.1 percent per annum by December 2007. The interest rate on new foreign exchange credits in 2007 increased insignificantly—from 10.6 percent per annum in December 2006 to 11 percent per annum in December 2007.

With the euro and Russian ruble exchange rates growing in the world markets, higher rates of growth of foreign exchange deposits of natural persons and organizations compared to ruble ones led to deteriorating money supply structure, whose ruble component fell by 3.5 percentage points in 2007, while the foreign exchange component of broad money supply grew correspondingly, which is an indication of growing currency replacement.

Increasing volumes of exports and imports of goods and services and capital flows were responsible for high activity of market participants in 2007 in foreign exchange purchase and sales operations.

The domestic foreign exchange market turnover increased compared to 2006 by 17.1 percent. The OTC segment of the foreign exchange market accounted for the largest share in the structure of



²¹ From 9.4 percent per annum in December 2006 to 12.7 percent per annum in March 2007 for legal persons, and from 10.9 to 12.4 percent per annum, respectively, for natural persons.

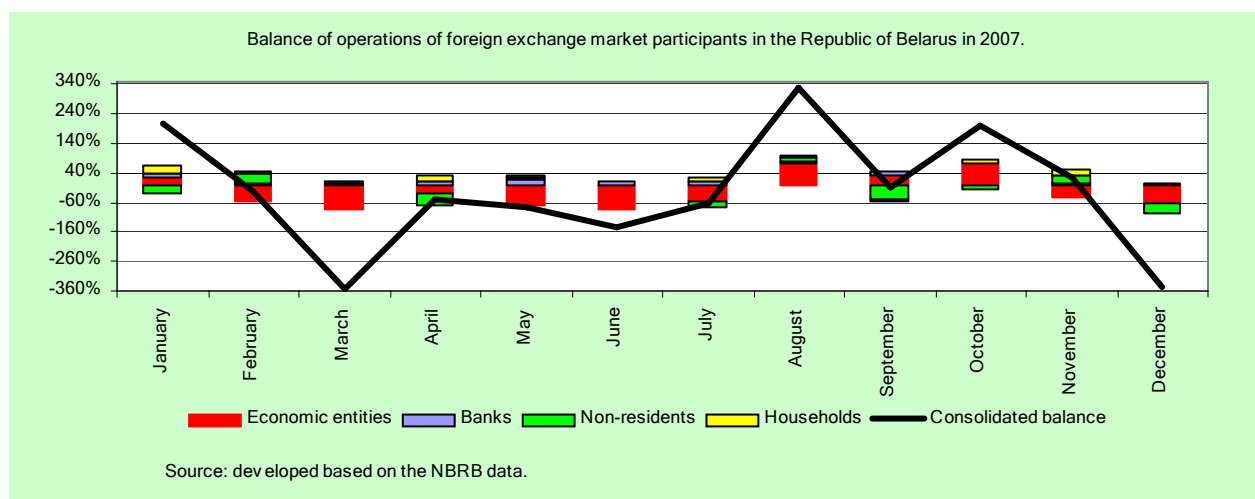
²² By December 2007 the interest rate on deposits of legal persons decreased to 9.6 percent per annum, while on deposits of natural persons it increased to 13.5 percent per annum.

²³ In real terms in 2007, interest rate on new time deposits of natural persons in domestic currency amounted to 1 percent per annum, while in 2006 it was 5 percent per annum.

²⁴ Without soft credits extended by decisions of the President of the Republic of Belarus, Government, as well as credits extended with the use of relevant credits of the National Bank and government authorities.

operations, and has remained dominant thus far—61.2 percent of operations. The trend towards increasing the volume of foreign exchange operations in the cash foreign exchange market continued to run its course, the share of such operations in 2007 amounted to 18.5 percent. The capacity of the foreign exchange market increased as a result of considerable growth of operations of economic entities, households, and banks, while participation of non-residents in foreign exchange market operations declined significantly.

As a result of faster growth of purchase compared with the growth of sales, the volume of net foreign exchange sales by resident economic entities fell by 39.6 percent, amounting to USD757 million compared to USD1,255 million in 2006. The volume of net demand for foreign exchange on the part of households (paid for in cash and by non-cash transfers) decreased from USD757 million in 2006 to USD418 million in 2007. Non-residents' net demand for foreign exchange declined 3.2 times, from USD852 million to USD263 million²⁵. In 2007, resident banks sold foreign exchange on net basis in the amount of USD224 million compared to USD402 million in 2006.



In 2007, the Belarusian securities market continued to experience uneven development. Its most developed segment is the government securities (hereinafter referred to as “GS”) market. At the same time, securities market liquidity, including the GS market, lacks adequate characteristics.

In 2007, the volume of GS in circulation increased by 556 billion Belarusian rubles (by 17 percent), to 3.8 trillion Belarusian rubles at face value as of January 1, 2008. The average weighted GS maturity was 414 days (294 days in 2006), the average weighted yield was 10.84 percent per annum (10.3 percent in 2006).

²⁵ Reduction of non-residents' operations in the domestic foreign exchange market was primarily caused by the reduction of Belarusian ruble use in foreign trade operations settlements by 31.4 percent in 2007 compared to 2006, as well as by poor development of the domestic financial market.

In spite of the growing volume of GS in circulation, banks' claims on the Government of the Republic of Belarus (excluding the National Bank's portfolio) denominated in securities fell in 2007 by 80.3 billion Belarusian rubles at book value, or by 3.1 percent, amounting to 2,517 billion Belarusian rubles. This was due to a significant increase in the GS portfolio of the National Bank during 2007 (more than twofold) as a result of GS purchase "until redemption" from banks' portfolio and restructuring of debt under credit extended by the National Bank to the Government of the Republic of Belarus into securities.

As of January 1, 2008, a mere 47 percent of GS in circulation (excluding the National Bank's portfolio) were actively traded in the secondary market and had a market value which is an indication that the GS market is insufficiently liquid.

During 2007, the National Bank engaged in operations designed to withdraw liquidity by means of placing own short-term bonds. Their maturities varied from 6 to 90 days depending on the current situation in the market; the average weighted maturity in 2007 was 14 days, declining by 7 days compared to 2006. The average weighted yield of short-term bonds in 2007 was 10.21 percent per annum (9.61 percent in 2006); the volume of placement was 8 trillion Belarusian rubles at sales price (2 trillion Belarusian rubles in 2006).

The segment of corporate securities in the Republic of Belarus is represented mainly by shares and bonds. Financial instruments of the term market (futures, options) based on underlying assets are practically not used because of lack of a liquid underlying asset.

Capitalization of the primary market of shares (volume of share issue) as of January 1, 2008 was 16.8 trillion Belarusian rubles, or 17.4 percent of GDP which is much lower than the level of developed market economies. The total amount of issue of shares of joint-stock companies in 2007 (owing to new issues and changes in the face value) for issuers operating as of January 1, 2008 amounted to 3 trillion Belarusian rubles.

In 2007, 59 issues of corporate bonds were registered totaling 385 billion Belarusian rubles, USD21.5 million, and EUR13.4 million, of which about 70 percent were banks' bonds secured by obligations to repay credit for housing construction, reconstruction, or purchase against security of immovable property.

In 2007, the total volume of transactions involving shares in the secondary market amounted to 6.1 trillion Belarusian rubles, whilst the volume of stock exchange operations was as low as 7.9 billion Belarusian rubles which proves that activity in this segment of the market remains low. Significant volumes of OTC transactions are associated with targeted privatization transactions on selling state-owned blocks of shares of enterprises of the financial and non-financial sectors of the Belarusian economy to strategic foreign investors.

The volume of secondary operations with securities in the stock exchange in 2007 in aggregate amounted to 254 billion Belarusian rubles, significantly exceeding the 2006 level (3.1 billion Belarusian rubles).

The bank credit market remained one of the major sources of funding the non-financial sectors of the economy of the Republic of Belarus in 2007, and the rate of growth of bank lending to the economy was significantly higher than the rate of GDP growth.

Lending is used by banks to compensate the shortage of economic entities' financing from other sources which leads to excessive development of banks' lending function to the detriment of the development of their investment and trade operations with securities and is reflected in poor diversification of banks' assets.

The compensatory role of bank lending was most of all reflected in financing investment into fixed capital and other long-term investment in the sector of non-financial enterprises. As of January 1, 2008, the share of debt under long-term credit in banks' credit portfolio amounted to 75.7 percent, increasing during 2007 by 21.7 percentage points. 57.4 percent of long-term bank credit was used to finance enterprises' working capital.

In 2007, the gap between growth of banks' claims on the economy in comparable prices and real GDP growth expanded. The increase in banks' claims on the economy in Belarusian rubles and in foreign exchange in real terms in 2007 averaged 35 percent relative to 2006²⁶, with real GDP growing by 8.2 percent in 2007.

Credit expansion of banks in the Republic of Belarus was to a large extent stimulated through the mechanism of government programs, in which banks' participation carries a number of risks to the banking system.

As of January 1, 2008, debt under credit and other asset operations restructured in accordance with Decrees of the President of the Republic of Belarus amounted to 330 billion Belarusian rubles, increasing fivefold over the year. The volume of new credits extended by banks under government programs, a significant part of which are long-term credits, increased by 41.2 percent in 2007, amounting to 6.1 trillion Belarusian rubles, or 13.3 percent of the total volume of credits in 2007.

Given current structure of obligations, the growing share of long-term debt in banks' credit portfolio is conducive to maintaining maturity mismatch between assets and liabilities in the banking sector and banks' requirements to use long-term (revolving) centralized credit resources to refinance their assets, as well as reduces the capacity of further lending to the economy and has a negative impact on the profitability of banking activity.

²⁶ The calculation has been made based on the GDP deflator of 112.1 percent.

Bank lending under government programs to industries, regions, and enterprises plays the role of a non-market means of competition which increases credit indebtedness of borrowers with a low level of economic efficiency. State-owned banks' liquidity gets increasingly dependent on budget planning and centralized resources. The volumes of funds spent by the state on building up state-owned banks' capital are inadequate compared to the volume of bank lending under government programs.

In 2007 and during 2008, the problem of conditionality of guarantees of the Government of the Republic of Belarus and local executive and administrative authorities retained its topicality which increases banks' credit risk when they implement government programs.

The problem of liquidity of those banks that participate in financing government programs is partially tackled by means of placing with state-owned banks time deposits of the Government of the Republic of Belarus (which, however, are insufficient to adequately provide financed programs with resources), but this practice has a negative impact on the mechanism of banking sector liquidity regulation and limits the effectiveness of monetary policy.

CHAPTER 5. PAYMENT SYSTEM OF THE REPUBLIC OF BELARUS

In 2007, measures were taken to ensure stable and smooth operation of the payment system of the Republic of Belarus; work was ongoing to improve the procedures for managing main risks affecting systemically important payment systems.

The most important achievement in the operation of the payment system of the Republic of Belarus in 2007 was smooth performance of settlements and payments for all economic entities within the framework of the automated system of interbank settlements (hereinafter referred to as the “ASIS”). From the point of view of financial stability, the major object of monitoring in the payment system was systemic risk and its main components: settlement risk (liquidity and credit risks) and operational risk.

Risk management in the payment system of the Republic of Belarus was effected on the basis of measures aimed at full compliance with the Core Principles for Systemically Important Payment Systems developed by the Committee on Payment and Settlement Systems of the Bank for International Settlements (Appendix 5). In accordance with the international practice and recommendations of international organizations, a special subdivision was established at the National Bank in August 2007 to effect oversight of the country’s payment system which monitors the main risks associated with the system’s operation.

The major approaches to managing systemic risk and its components in 2007 were the improvement of the software and hardware infrastructure of the payment system and implementation of efficient tariff policies.

Putting the modernized BISS system—a system of interbank settlements operating on the gross basis with some elements of clearing—into industrial operation in 2005 made it possible in 2007, along with the expansion of the ASIS operation characteristics, to implement procedures for managing credit and liquidity risks based on the division of payment flows into urgent and non-urgent electronic payment documents and the off-setting of non-urgent electronic payment documents.

In 2007, liquidity risk was managed by means of improving tariff policies aimed at ensuring even distribution of payment flows within a transaction day through the use of differentiated ratios applied to tariffs for processing payments at different time intervals, as well as procedures for providing banks with intraday liquidity of the National Bank. One of the key measures aimed at improving the procedures for providing banks with intraday liquidity of the National Bank within the framework of liquidity risk management in 2007 was to enhance efficient functioning of the mechanism of required reserves creation and their use in settlements.

One of the priority measures to prevent technical and technological components of operational risk in the Republic of Belarus in 2007 was to improve the procedures for oversight of the status and functioning of the ASIS software and hardware infrastructure. To this end, the National Bank, together with other banks, paid much attention to training staff in a force-majeure environment to ensure smooth operation of the ASIS and restore its functioning in the shortest time possible in case of failure or malfunction, as well as in case of possible man-caused disasters and other circumstances, which can impair the efficiency of software and hardware complexes and telecommunication networks.

The current system of software and hardware standardization and certification in the area of banking services and technologies continued improving; a number of technical regulatory legal acts were developed to establish requirements to the software and hardware used in the payment system to be complied with. On the whole, the implementation of the aforementioned measures made it possible to reduce the number of failures in the ASIS, as well as down-time resulting therefrom. At the end of 2007, the average value of the parameter of clients' access to the ASIS (cumulative from the beginning of the year) amounted to 99.83 percent, the requirement being at least 99.5 percent.

ASSESSING VULNERABILITY OF THE BANKING SECTOR OF THE REPUBLIC OF BELARUS

To assess the vulnerability of the banking sector of the Republic of Belarus to various shocks caused by macroeconomic developments, all major types of risks inherent in banking activity were stress tested.

To stress test the vulnerability of the banking sector to credit, foreign exchange, and interest risks, a methodology was used underlying which was the calculation of net losses caused by the set shocks and the charging of those losses to the capital account. The capital adequacy ratio was calculated simultaneously with the comparison of losses with profits gained by banks in the preceding 12 months.

In stress testing vulnerability to liquidity risk, the change in liquidity ratios in case of a sharp change in the level of liquid liabilities was calculated.

The banking sector's sensitivity was tested on the following assumptions:

- the share of problem assets increases by 15 percentage points on the assumption that the structure of problem assets remains in the proportions close to those existing as of January 1, 2008 in the banking sector as a whole, and the share of Group II assets increases by a similar amount (shock 1);
- the Belarusian ruble/US dollar exchange rate declines by 20 percent (shock 2);
- there is a parallel increase in the Belarusian ruble yield curve by 1,000 basis points (shock 3); and
- natural and legal persons withdraw 20 percent of their deposits in banks (shock 4).

Findings of stress testing suggest that the banking sector is highly vulnerable to a significant deterioration in asset quality. If the chosen shock materializes, the regulatory capital adequacy ratio would decline by 7.7 percentage points, although its value would remain above the level prescribed for individual banks.

Foreign banks¹ in which the decline in regulatory capital adequacy would be the largest, reaching, however, the lowest level compared to other banks, would be hit hardest. From the point

¹ Here and hereinafter:

All banks (ALL)

State-owned banks (SOB), i.e. a group of banks with the predominant share of government agencies and state entities in the authorized capital.

Foreign banks (FB), i.e. a group of banks with the predominant share of foreign capital in their authorized capital.

Private banks (PB), i.e. a group of banks not included in groups SOB and FB.

Large banks (LB), i.e. a group of banks whose share of assets exceeds 5 percent of total assets of the banking sector.

of view of the size of losses, state-owned banks would incur the largest losses (5.7 times exceeding their annual profits). Losses in the banking sector as a whole would exceed banks' annual profits nearly fivefold, amounting to 3 percent of GDP.

Table

FINDINGS OF STRESS TESTING

the banking sector (impact on the regulatory capital adequacy ratio), percent

Value	ALL	SOB	FB	PB	LB	MB	SB
Actual	19.31	19.63	17.84	19.81	18.62	17.68	42.46
Credit shock (shock 1)							
Calculated	11.65	12.01	9.78	13.21	10.84	10.00	37.62
Change	-7.66	-7.62	-8.06	-6.60	-7.78	-7.68	-4.84
Foreign exchange risk (shock 2)							
Calculated	19.22	19.52	17.81	19.75	18.50	17.67	42.55
Change	-0.09	-0.11	-0.03	-0.06	-0.12	-0.01	0.09
Interest risk (shock 3)							
Calculated	17.78	17.89	17.11	18.67	16.96	16.95	41.62
Change	-1.53	-1.74	-0.73	-1.14	-1.66	-0.73	-0.84
Combination of foreign exchange and credit risks (shock 5)							
Calculated	11.46	12.75	5.20	10.54	11.23	3.87	37.72
Change	-7.85	-6.88	-12.64	-9.27	-7.39	-13.81	-4.74

Source: developed based on the NBRB data.

Testing banks' sensitivity to direct foreign exchange risk showed that the consequences of the chosen shock for banks would be insignificant. The regulatory capital adequacy ratio would decline by about 0.1 percentage points and losses about 6.5 percent of annual profits.

If interest rates go up by 1,000 basis points, the banking sector would incur losses comparable to its annual profits. It would primarily apply to state-owned banks, whose losses would exceed annual profits 1.4 times, while losses of foreign and private banks would amount to 62 and 32 percent of profits respectively.

If a crisis hits causing withdrawal of 20 percent of funds placed with banks by natural and legal persons, the banking sector would face serious challenges. With the exception of the instantaneous liquidity ratio, all liquidity ratios calculated for the banking sector would be below the requirements set for individual banks. As a result of this shock, the ratio of liquid assets to total assets would fall to 12.7 percent, the current liquidity ratio to 56.5 percent, and the short-term liquidity ratio to 0.7. This deterioration in the banking sector liquidity is primarily due to the lack of liquid assets in state-owned banks, whose liquidity indicators would be substantially below the

Medium banks (MB), i.e. a group of banks whose share of assets exceeds 5 percent of assets of banks not included in group LB.

Small banks (SB), i.e. a group of other banks not included in groups LB and MB.

requirements, while foreign and private banks have enough liquidity to honor their liabilities to clients on demand.

Table

FINDINGS OF STRESS-TESTING
the banking sector (impact on liquidity ratios)

Value	ALL	SOB	FB	PB	LB	MB	SB
Instantaneous liquidity ratio, percent							
Actual	104.05	74.91	145.96	158.38	98.44	133.55	119.99
Calculated	59.91	0.07	123.59	72.10	56.61	70.29	89.58
Change	-44.14	-74.84	-22.37	-86.28	-41.83	-63.26	-30.41
Current liquidity ratio, percent							
Actual	98.78	83.27	127.05	128.87	93.51	118.14	141.29
Calculated	56.52	19.82	116.27	100.72	45.94	93.00	136.93
Change	-42.26	-63.45	-10.78	-28.15	-47.57	-25.14	-4.36
Short-term liquidity ratio							
Actual	1.97	1.66	3.07	2.75	1.80	2.80	2.73
Calculated	0.71	0.43	2.51	1.02	0.60	1.82	1.62
Change	-1.26	-1.23	-0.56	-1.73	-1.20	-0.98	-1.11
Ratio of liquid assets to total assets, percent							
Actual	22.60	17.90	39.02	30.03	21.00	33.06	31.97
Calculated	12.73	6.47	33.70	20.71	10.71	24.83	26.72
Change	-9.87	-11.43	-5.32	-9.32	-10.29	-8.23	-5.25

Source: developed based on the NBRB data.

Along with sensitivity tests, the National Bank conducted scenario analysis aimed at assessing the degree of vulnerability of the banking sector in case of a combined foreign exchange and credit risks shock (shock 5). The scenario was based on the following assumptions: the Belarusian ruble/ US dollar exchange rate drops by 20 percent; as a result, 80 percent of foreign exchange credits extended to agriculture, construction, and households, as well as 20 percent of credits to industry and other sectors would become problem ones and would be classified as Group V assets.

The results of scenario analysis showed that if the scenario materializes, the banking sector would incur significant losses. The regulatory capital adequacy ratio would decline by 7.9 percentage points amounting to 11.5 percent. Hardest hit would be medium-size and foreign banks, whose regulatory capital adequacy would be the lowest among corresponding groups of banks—3.9 and 5.2 percent respectively. The amount of losses in the banking sector as a whole would be six times the volume of profits earned by banks over the year, or 3.7 percent of GDP.

On the whole, stress testing has shown that the banking sector is highly vulnerable to a hypothetical reduction in the quality of its credit portfolio. If the financial condition of borrowers deteriorates substantially and the volume of past-due credits increases, banks would face losses significantly exceeding their profits in the previous year. This would especially show up if indirect

foreign exchange risk materializes, when as a result of a sharp depreciation of Belarusian ruble many clients would default on their foreign exchange obligations to banks. The direct impact of Belarusian ruble depreciation would be insignificant.

Besides, in spite of excess liquidity in 2007, the banking sector remained vulnerable to clients' run on banks.

MACROECONOMIC INDICATORS

Table

WORLD ECONOMIC DEVELOPMENT
in 2007: rates of real GDP growth, % of previous period²

Region	2006	2007	2008	2009
World economy in general	5	4.9	3.7	3.8
Developed countries	3	2.7	1.3	1.3
USA	2.9	2.2	0.5	0.6
Euro zone	2.8	2.6	1.4	1.2
Germany	2.9	2.5	1.4	1
France	2	1.9	1.4	1.2
Italy	1.8	1.5	0.3	0.3
Spain	3.9	3.8	1.8	1.7
Japan	2.4	2.1	1.4	1.5
UK	2.9	3.1	1.6	1.6
Canada	2.8	2.7	1.3	1.9
Other developed countries	4.5	4.6	3.3	3.4
New industrialized economies of the Asian region	5.6	5.6	4	4.4
Emerging market economies	7.8	7.9	6.7	6.6
Africa	5.9	6.2	6.3	6.4
South Sahara	6.4	6.8	6.6	6.7
Central and Eastern Europe	6.6	5.8	4.4	4.3
CIS	8.2	8.5	7	6.5
Russia	7.4	8.1	6.8	6.3
Without Russia	10.1	9.6	7.4	7
Developing Asian countries	9.6	9.7	8.2	8.4
China	11.1	11.4	9.3	9.5
India	9.7	9.2	7.9	8
ASEAN countries	5.7	6.3	5.8	6
Middle East	5.8	5.8	6.1	6.1
Western hemisphere	5.5	5.6	4.4	3.6
Brazil	3.8	5.4	4.8	3.7
Mexico	4.8	3.3	2	2.3
European Union	3.3	3.1	1.8	1.7

Source: World Economic Outlook / April 2008. – Washington D.C.:IMF, 2008. – P.1

² Based on the IMF World Economic Outlook methodology.

MAIN MACROECONOMIC INDICATORS
of instability emergence and development in the banking sector as at January 1, 2008

Indicators, whose dynamics is evidencing the downturn (maintenance at the same level) in the potential emergence of instability in the banking sector in 2007	Indicators, whose dynamics is evidencing the upsurge in the potential emergence of instability in the banking sector in 2007
Real GDP growth was 108.2 percent (in 2006, 110 percent).	Exports, imports, current account deficit (in 2007, the rates of export growth were 24.6 percent, those of imports - 28.0 percent; the negative balance of foreign trade was USD2,738.7 million compared with USD1,514.9 million in 2006).
Real industrial output growth was 108.5 percent (in 2006, 111.4 percent).	Rate of inflation (in 2007, the CPI grew by 12.1 percent, compared with 6.6 percent in 2006). The PPI grew by 16.8 percent (in 2006, 9 percent).
Share of loss-making enterprises in their total number was 6.3 percent in 2007, compared with 8.3 percent in 2006.	Level of profitability of sold industrial products dropped from 13.2 percent in 2006 to 12 percent in 2007. As at January 1, 2008, stocks of unsold output in industry as a whole increased in actual prices by 25.6 percent compared with January 1, 2007, with the PPI growing by 17.1 percent.
As of January 1, 2008, domestic government debt was 6.4 percent of GDP, compared with 6.5 percent of GDP as of January 1, 2007.	Dollarization of the economy (the share of foreign exchange in the broad money supply increased by 3.4 percentage points, amounting to 32.2 percent as at January 1, 2008).
Consolidated budget surplus (422.1 billion Belarusian rubles, or 0.4 percent of GDP).	In 2007, external debt increased by USD1,499 million, amounting to USD2,337 million as at January 1, 2008, or 5.2 percent of GDP, compared with 2.3 percent of GDP as at January 1, 2007.
Share of the time component in M2 (share of time deposits in the ruble money supply as of January 1, 2008 was 43.6 percent, increasing over the year by 0.9 percentage points).	In 2007, external debt increased to USD12.9 billion, or by 91.1 percent.
Relative level of gold and foreign exchange reserves in months of imports (increased to 1.65 months as at January 1, 2008 from 0.7 months as at January 1, 2007).	

Source: developed based on the RB MoSA and NBRB data.

MAIN INDICATORS
of international operations of the Republic of Belarus in 2005-2007, million USD

Indicators	2005	2006	2007
Foreign trade balance	341.8	-1,514.9	-2,738.7
% of GDP	1.2	-4.1	-6.1
Current account balance	435.5	-1,431.2	-2,944.2
% of GDP	1.5	-3.9	-6.6
Balance of investments	-45.7	1,706.2	5,376.8
% of GDP	-0.2	4.6	12.0
of which, net inflow of direct investment	302.5	351.0	1,768.9
	1.0	0.9	4.0
Balance of payments (increase in reserve assets)	539.2	-1.4	2,778.1
% of GDP	1.8	0.0	6.2
Foreign debt (as at January 1 of the following year)	5,740.8	6,785.7	12,719.2
% of GDP	19.4	18.4	28.4
of which, short-term debt	4,509.1	4,719.8	8,045.3
% of GDP	15.2	12.8	18.0
Macroeconomic ratios			
Export of goods to GDP, %	61.5	53.6	54.6
Import of goods to GDP, %	60.3	59.8	63.3
Reserve assets in days of import of goods and services	26.2	22.5	53.2

Source: developed based on the RB MoSA and NBRB data.

DYNAMICS

of financial performance of enterprises of the non-financial sector in 2007, billion Belarusian rubles

	2006	2007	Rate of growth, %
Sales proceeds	159,201	203,707	128.0
of which:			
Paid for in monetary funds	143,597	186,430	129.8
% of sales proceeds	90.2	91.5	
Not paid for by buyers	5,281.0	7,022.0	133.0
% of sales proceeds	3.3	3.4	
Taxes and fees paid from sales proceeds	19,193	26,462	137.9
% of sales proceeds	12.1	13.0	
Acquisition value of goods	33,695	43,709	129.7
% of sales proceeds	21.2	21.5	
Cost of sold products	93,904	119,258	127.0
% of sales proceeds	59.0	58.5	
Profits from sales	12,409	14,277	115.1
% of sales proceeds	7.8	7.0	
Profits before tax	11,925	13,787	115.6
% of sales proceeds	7.5	6.8	
Taxes and fees paid from profits	3,927	4,584	116.7
% of profit before tax	32.9	33.2	
Net profits	7,921	9,125	115.2
Profitability of sales, %	7.8	7	
Profitability of sold products, %	13.2	12	
Share of loss-making enterprises, %	8.3	6.3	

Source: developed based on the RB MoSA and NBRB data.

RATE OF GROWTH
of profits by industry in 2007, %

	Rates of profit growth					
	From products sale		Before tax		Net	
	nominal	Real	nominal	real	nominal	real
Republic of Belarus	115.1	102.7	115.6	103.1	115.2	102.8
of which:						
Industry	109.2	97.4	109.7	97.9	109.5	97.7
Power industry	90.9	81.1	95.9	85.5	103.8	92.6
Fuel industry	40.8	36.4	39	34.8	36.2	32.3
Ferrous metallurgy	168.2	150.0	204.1	182.1	247.2	220.5
Chemical and petrochemical industry	125.1	111.6	128.2	114.4	124.3	110.9
Machinery building and metal processing	136.5	121.8	139.4	124.4	139.7	124.6
Timber, woodworking and pulp and paper industry	184.1	164.2	184.2	164.3	214.8	191.6
Construction materials	163.5	145.9	177	157.9	198.3	176.9
Light industry	134.4	119.9	128.1	114.3	124.9	111.4
Food industry	143.8	128.3	137.4	122.6	137	122.2
Agriculture	294.1	262.4	132.1	117.8	133.2	118.8
Transport	135.8	121.1	152.9	136.4	179.3	159.9
Construction	112.1	100.0	108.2	96.5	104.4	93.1
Trade and public catering	141.7	126.4	128.7	114.8	124.5	111.1

Source: developed based on the RB MoSA data.

PROFITABILITY

of sold products, work, and services in 2007, %

	2006	2007	Deviation, percentage points
Total	13.2	12	-1.2
of which:			
Industry	15.6	13	-2.6
Power industry	12.9	8.4	-4.5
Fuel industry	29.7	7.8	-21.9
Oil refining	22.7	3.1	-19.6
Ferrous metallurgy	17.5	22.4	4.9
Chemical and petrochemical industry	27.1	26.1	-1
Chemical	26.7	27.6	0.9
Petrochemical	29.1	19.3	-9.8
Machinery building and metal processing	13.4	14.3	0.9
Timber, woodworking and pulp and paper industry	7.4	10.8	3.4
Construction materials	10.2	12.4	2.2
Light industry	6.6	7.9	1.3
Food industry	8.4	10.1	1.7
Agriculture	2.1	5.2	3.1
Transport	14	15.7	1.7
Communication	45.1	40.4	-4.7
Construction	11.2	9.7	-1.5
Trade and public catering	16.4	17.9	1.5
Logistics and sales	31.6	34.7	3.1
Housing and utilities	4	4	0

Source: developed based on the RB MoSA data.

DYNAMICS
of payables and receivables in 2007, billion Belarusian rubles

	01.01.2007	01.01.2008	Increase	Rate of growth, %
Payables	25,955	31,860	5,905	122.8
of which: in arrears	4,091.1	4,246	155	103.8
% of total	15.8	13.3		
Receivables	18,586.9	24,560	5,973	132.1
of which: in arrears	3,603.8	3,883	279	107.7
% of total	19.4	15.8		
Net payables	7,368	7,300	-68	99.1
% of receivables	39.6	29.7		
Net payables in arrears	487	363	-124	74.5
% of receivables	13.5	9.3		
Share of organizations having arrears (% of total number)				
payables	56.9	55.2		
receivables	66	65.7		
External payables:	4,732	6,997	2,265	147.9
of which: in arrears	568	674	106	118.7
% of total external payables	12.0	9.6		
External receivables	2,752	4,651	1,899	169.0
of which: in arrears	263	342	79	130.0
% of total external receivables	9.6	7.4		
Net external payables	1,980	2,346	366	118.5
% of external payables	71.9	50.4		
Net external payables in arrears	305	332	27	108.9
% of net external payables	15.4	14.2		
Monetary funds on organizations' accounts	4,712	6,660	1,948	141.3
Current solvency, %	115.2	156.9		

Source: developed based on the RB MoSA data.

DYNAMICS
of monetary funds on enterprises' accounts, billion Belarusian rubles

	01.01.2007	01.01.2008	Increase	Share in increase, %	Rate of growth, %
Total	4,712.9	6,659.9	1,947.0	100	141.3
of which:					
Industry	2,428.7	3,285.7	857.0	44.0	135.3
Power industry	59.4	89.0	29.6	1.5	149.8
Fuel industry	690.8	497.5	-193.3	-9.9	72.0
Oil refining	633.2	479.5	-153.7	-7.9	75.7
Ferrous metallurgy	68.1	139.8	71.7	3.7	205.3
Chemical and petrochemical industry	308.6	403.6	95.0	4.9	130.8
Chemical	277.7	363.5	85.8	4.4	130.9
Petrochemical	31.0	40.1	9.1	0.5	129.4
Machinery building and metal processing	905.6	1,574.1	668.5	34.3	173.8
Automobile	553.9	851.8	297.9	15.3	153.8
Tractor and agricultural machinery building	38.0	293.8	255.8	13.1	773.2
Timber, woodworking and pulp and paper industry	46.2	71.7	25.5	1.3	155.2
Construction materials	68.6	98.3	29.7	1.5	143.3
Light industry	70.2	64.2	-6.0	-0.3	91.5
Food industry	127	230.6	103.6	5.3	181.6
Flour-and-cereals and combined fodder industry	23.6	15.4	-8.2	-0.4	65.3
Agriculture	118	154.1	36.1	1.9	130.6
Transport	286.5	583.7	297.2	15.3	203.7
Pipeline transportation	151.6	405.5	253.9	13.0	267.5
Communication	243.8	393.6	149.8	7.7	161.4
Construction	439.2	522.2	83.0	4.3	118.9
Trade and public catering	426.5	622.1	195.6	10.0	145.9
Logistics and sales	72.6	51.6	-21.0	-1.1	71.1
Housing and utilities	95.9	157.0	61.1	3.1	163.7

Source: developed based on the RB MoSA data.

DYNAMICS

of outstanding bank loans in 2007, billion Belarusian rubles

	01.01.2007	01.01.2008	Increase	Share in increase, %	Rate of growth, %
Total	14,301.9	22,029.1	7,727.2	100	154.0
of which:					
Industry	6,628.5	10,285.8	3,657.3	47.3	155.2
Power industry	496.2	643.7	147.5	1.9	129.7
Fuel industry	213.7	1,477.4	1,263.7	16.4	691.3
Oil refining	176.3	1,220.1	1,043.8	13.5	692.1
Ferrous metallurgy	570.6	955.9	385.3	5.0	167.5
Chemical and petrochemical industry	534.3	888.0	353.7	4.6	166.2
Chemical	509.9	691.2	181.3	2.3	135.6
Petrochemical	24.4	196.8	172.4	2.2	8.1 p.
Machinery building and metal processing	1,611.9	1,946.0	334.1	4.3	120.7
Automobile	368.8	351.4	-17.4	-0.2	95.3
Tractor and agricultural machinery building	521.2	557.4	36.2	0.5	106.9
Timber, woodworking and pulp and paper industry	263.7	307.4	43.7	0.6	116.6
Construction materials	171.6	305.7	134.1	1.7	178.1
Light industry	307.0	343.8	36.8	0.5	112.0
Food industry	1,836.6	2,445.5	608.9	7.9	133.2
Flour-and-cereals and combined fodder industry	424.4	700.7	276.3	3.6	165.1
Agriculture	3,398.0	4,643.2	1,245.2	16.1	136.7
Transport	402.9	1,156.0	753.1	9.7	286.9
Pipeline transportation	41.9	673.9	632.0	8.2	16.1 p.
Communication	251.6	432.3	180.7	2.3	171.8
Construction	381.4	690.7	309.3	4.0	181.1
Trade and public catering	1,294.5	2,105.7	811.2	10.5	162.7
Logistics and sales	832.1	1,219.7	387.6	5.0	146.6
Housing and utilities	253.4	298.4	45.0	0.6	117.8

Source: developed based on the RB MoSA data.

DYNAMICS

of current solvency in 2007 (ratio of monetary funds to payables in arrears), %

	01.01.2007	01.04.2007	01.10.2007	01.01.2008
Total	115.2	106.2	112.1	156.9
Industry	140.7	119.5	133.7	193.8
Agriculture	11.5	13.6	12.0	13.4
Transport	185.1	394.9	224.3	288.4
Construction	199.6	91.2	118.2	191.5
Trade and public catering	115.6	87.8	132.3	146.6
Logistics and sales	122.2	321.7	92.3	87
Housing and utilities	35.4	37.0	43.0	71.5

Source: developed based on the RB MoSA data.

INDICATORS OF PERFORMANCE OF THE BANKING SECTOR OF THE REPUBLIC OF BELARUS, 2006-2007

Table

MAIN INDICATORS

of performance of the banking sector of the Republic of Belarus

Date	All banks ³	Large banks			Medium banks			Small banks		
	ALL	SOB	FB	PB	SOB	FB	PB	SOB	FB	PB
Number of banks, units										
01.01.2007	29	4	1	0	0	4	2	1	12	5
01.01.2008	27	4	1	0	0	6	1	1	9	5
Assets, trillion Belarusian rubles										
01.01.2007	29.18	23.01	2.36	0	0	1.39	1.22	0.13	0.46	0.60
01.01.2008	41.94	31.86	4.19	0	0	3.56	0.99	0.21	0.54	0.59
Liabilities, trillion Belarusian rubles										
01.01.2007	23.99	18.84	2.00	0	0	1.21	1.08	0.08	0.33	0.44
01.01.2008	35.26	26.66	3.77	0	0	3.07	0.89	0.10	0.35	0.42
Capital, trillion Belarusian rubles										
01.01.2007	5.19	4.17	0.36	0	0	0.18	0.14	0.05	0.13	0.16
01.01.2008	6.68	5.20	0.42	0	0	0.48	0.10	0.11	0.19	0.17
Profits, billion Belarusian rubles										
01.01.2007	411.2	270.6	70.4	0	0	33.5	19.7	1.8	-1.0	16.1
01.01.2008	602.4	393.4	76.6	0	0	75.1	13.0	7.1	19.0	18.2
Share of bank groups in assets, %										
01.01.2007	100.0	78.9	8.1	0	0	4.8	4.2	0.4	1.6	2.1
01.01.2008	100.0	76.0	10.0	0	0	8.5	2.4	0.5	1.3	1.4
Share of bank groups in liabilities, %										
01.01.2007	100.0	78.5	8.3	0	0	5.0	4.5	0.3	1.4	1.8
01.01.2008	100.0	75.6	10.7	0	0	8.7	2.5	0.3	1.0	1.2
Share of bank groups in capital, %										
01.01.2007	100.0	80.3	7.0	0	0	3.5	2.7	0.9	2.5	3.1
01.01.2008	100.0	77.9	6.3	0	0	7.2	1.6	1.6	2.8	2.6

Source: developed based on the NBRB data.

³ As of January 1, 2007 the balance sheet and statistical reports were submitted to the National Bank by 29 banks, as of January 1, 2008 – by 27 banks.

INDICATORS

of financial stability of the banking sector of the Republic of Belarus, 2006-2007, %

	INDICATORS	01.01.2006	01.01.2007	Change	01.01.2007	01.01.2008	Change
	Capital adequacy						
1	Regulatory capital adequacy ratio	26.66	24.39	-2.27	24.39	19.31	-5.08
2	Fixed capital adequacy ratio (Tier I)	18.75	17.37	-1.38	17.37	14.03	-3.34
3	Capital to assets	19.67	17.79	-1.88	17.79	15.92	-1.87
	CREDIT RISK						
4	Growth of credit to the economy	18.88	32.52	13.64	32.52	36.19	3.58
5	Large open positions to regulatory capital	69.18	65.99	-3.19	65.99	101.43	35.44
6	Share of problem assets in total assets exposed to credit risk	3.12	2.83	-0.29	2.83	1.92	-0.91
7	Share of problem assets in total credit to the economy	1.88	1.16	-0.66	1.16	0.65	-0.51
8	Problem assets less provisions actually created against them to capital	6.29	6.12	-0.17	6.12	3.82	-2.30
9	Distribution of loans by branch						
	industry	40.25	37.85	-2.40	37.85	37.09	-0.76
	agriculture	18.15	20.19	2.04	20.19	19.81	-0.38
	construction	2.71	2.99	0.28	2.99	3.72	0.73
	trade and public catering	9.84	10.72	0.88	10.72	11.16	0.44
	housing and utilities	3.02	2.28	-0.74	2.28	1.42	-0.86
	Other	26.04	25.97	-0.07	25.97	26.80	0.83
	Incomes/returns						
10	Return on assets	2.57	2.39	-0.18	2.39	2.30	-0.09
11	Return on capital	12.94	12.86	-0.08	12.86	13.80	0.94
12	Interest margin to gross income	37.13	38.91	1.78	38.91	40.66	1.75
13	Non-interest expenses to gross income	75.03	74.85	-0.18	74.85	73.91	-0.94
14	Staff costs to non-interest expenses	30.15	33.23	3.08	33.23	31.51	-1.72
15	Interest rates spread						
	for all loans and deposits in Belarusian rubles	4.50	3.70	-0.80	3.70	5.30	1.60

	INDICATORS	01.01.2006	01.01.2007	Change	01.01.2007	01.01.2008	Change
	for new loans and deposits in Belarusian rubles	5.50	3.20	-2.30	3.20	3.00	-0.20
	for all foreign exchange loans and deposits	5.40	4.40	-1.00	4.40	4.40	0
	for new foreign exchange loans and deposits	4.60	3.40	-1.20	3.40	3.60	0.20
	Liquidity						
16	Liquid assets to total assets	30.36	24.11	-6.25	24.11	22.60	-1.51
17	Short-term liquidity, times	1.89	1.81	-0.08	1.81	1.97	0.16
18	Immediate liquidity	117.76	128.85	11.09	128.85	104.05	-24.80
19	Current liquidity	95.93	96.69	0.76	96.69	98.78	2.09
	<i>For information:</i>						
	Maturity mismatch between assets and liabilities over 12 months, trillion Belarusian rubles	-4.789	-6.155	-1.366	-6.155	-6.158	-0.003
	Foreign exchange risk						
20	Total open foreign exchange position to regulatory capital	13.14	9.53	-3.61	9.53	4.79	-4.74
21	Share of clients' debt on loans and other assets operations in foreign exchange in clients' total debt on loans and other assets operations	38.54	35.50	-3.04	35.50	39.11	3.61
22	Share of clients' resources in foreign exchange in total resources attracted from clients	36.99	34.68	-2.31	34.68	36.75	2.07

Source: developed based on the NBRB data.

DISTRIBUTION OF BANKS
by regulatory capital adequacy in 2007

Bank group	Number of banks							
	01.01.2007	CA* <= 0	0 < CA <= 8	8 < CA <= 16	16 < CA <= 24	24 < CA <= 30	30 < CA	Total
Banking sector		1	0	4	6	5	13	29
State-owned banks		0	0	2	1	0	2	5
Foreign banks		1	0	1	4	2	9	17
Private banks		0	0	1	1	3	2	7
Large banks		0	0	2	2	0	1	5
Medium banks		0	0	2	3	1	0	6
Small banks		1	0	0	1	4	12	18
	01.01.2008	CA <= 0	0 < CA <= 8	8 < CA <= 16	16 < CA <= 24	24 < CA <= 30	30 < CA	Total
Banking sector		0	0	5	7	2	13	27
State-owned banks		0	0	2	1	1	1	5
Foreign banks		0	0	2	5	1	8	16
Private banks		0	0	1	1	0	4	6
Large banks		0	0	3	1	1	0	5
Medium banks		0	0	2	4	0	1	7
Small banks		0	0	0	2	1	12	15

Source: developed based on the NBRB data.

*Regulatory capital adequacy ratio.

DISTRIBUTION OF BANKS
by share of problem assets in 2007

Bank group	Number of banks						
	share = 0	0 < share <= 1	1 < share <= 2	2 < share <= 4	4 < share <= 8	8 < share	Total
01.01.2007							
Banking sector	3	5	6	6	4	5	29
State-owned banks	0	2	1	1	1	0	5
Foreign banks	3	2	3	3	1	5	17
Private banks	0	1	2	2	2	0	7
Large banks	0	1	1	2	1	0	5
Medium banks	0	1	2	2	1	0	6
Small banks	3	3	3	2	2	5	18
01.01.2008							
Banking sector	4	10	6	4	2	1	27
State-owned banks	0	2	2	0	1	0	5
Foreign banks	4	5	3	4	0	0	16
Private banks	0	3	1	0	1	1	6
Large banks	0	2	2	0	1	0	5
Medium banks	0	2	2	3	0	0	7
Small banks	4	6	2	1	1	1	15

Source: developed based on the NBRB data.

DISTRIBUTION OF BANKS
by return on capital (before tax) in 2007

Bank group	Number of banks						
	ROC <= 0	0 < ROC <= 5	5 < ROC <= 10	10 < ROC <= 15	15 < ROC <= 20	20 < ROC	Total
01.01.2007							
Banking sector	3	3	3	6	2	12	29
State-owned banks	0	1	1	1	0	2	5
Foreign banks	3	1	1	4	1	7	17
Private banks	0	1	1	1	1	3	7
Large banks	0	0	1	1	0	3	5
Medium banks	0	0	0	0	2	4	6
Small banks	3	3	2	5	0	5	18
01.01.2008							
Banking sector	0	3	2	3	7	12	27
State-owned banks	0	0	2	1	0	2	5
Foreign banks	0	2	0	1	4	9	16
Private banks	0	1	0	1	3	1	6
Large banks	0	0	1	1	0	3	5
Medium banks	0	0	0	0	2	5	7
Small banks	0	3	1	2	5	4	15

Source: developed based on the NBRB data.

DISTRIBUTION OF BANKS
by return on assets (before tax) in 2007

Bank group	Number of banks						
	ROA <= 0	0 < ROA <= 0.5	0.5 < ROA <= 1	1 < ROA <= 2	2 < ROA <= 3	3 < ROA	Total
01.01.2007							
Banking sector	3	1	1	6	3	15	29
State-owned banks	0	0	0	3	1	1	5
Foreign banks	3	1	0	1	2	10	17
Private banks	0	0	1	2	0	4	7
Large banks	0	0	0	2	1	2	5
Medium banks	0	0	0	1	2	3	6
Small banks	3	1	1	3	0	10	18
01.01.2008							
Banking sector	0	0	1	2	5	19	27
State-owned banks	0	0	0	2	1	2	5
Foreign banks	0	0	0	0	2	14	16
Private banks	0	0	1	0	2	3	6
Large banks	0	0	0	2	1	2	5
Medium banks	0	0	0	0	3	4	7
Small banks	0	0	1	0	1	13	15

Source: developed based on the NBRB data.

LEASING OPERATIONS IN THE REPUBLIC OF BELARUS IN 2007

According to the Ministry of Statistics and Analysis of the Republic of Belarus, the number of assets hired out by lessors (excluding real estate operations) had increased by 18.7 percent by January 1, 2008, amounting to 77.8 thousand units. The contract value of these assets increased by 41.0 percent to 3,106.1 billion Belarusian rubles.

By the end of 2007, economic entities classified as belonging to the branch of the economy under “banking activity” had hired out assets worth 1,204.8 billion Belarusian rubles, or 38.8 percent of the total value of lease assets. Economic entities classified as belonging to the branch of the economy under “other financial and credit organizations” had hired out assets worth 1,901.4 billion Belarusian rubles, or 61.2 percent of the value of lease assets.

As of January 1, 2008, financial leasing accounted for the major share, in terms of both the number of current agreements and the contract value of lease assets, in the structure of leasing operations (99.9 percent), while the share of operational leasing was 0.1 percent.

As at December 31, 2007, the major lease assets were machinery and equipment (53.6 percent of the value of all lease assets) and means of transportation (36.3 percent), with the value of hired out means of transportation increasing over the year by 94.5 percent, machinery and equipment by 16.6 percent, and lease assets by 40.9 percent. Correspondingly, lessors’ major potential risks can be associated with the worsening of the financial situation in those industries which make an extensive use of these assets (for instance, transportation industry).

One can assume that in conducting leasing operations, non-bank intermediaries’ risk management systems are less efficient than those of the banking sector.

For example, past-due lease payments increased markedly in 2007, exceeding the volume of the economy’s and households’ problem debt under credit. According to the Ministry of Statistics and Analysis of the Republic of Belarus, overdue debt under lease contracts increased during the year by 52.9 percent and as of January 1, 2008 amounted to 237.4 billion Belarusian rubles, or 9.8 percent of the total amount of debt under lease contracts (as of January 1, 2007 it was 155.3 billion Belarusian rubles, or 9.0 percent).

For the sake of comparison: according to the National Bank, the economy’s and households’ problem debt to banks (less financial leasing) dropped in the previous year by 6.4 percent to 182.8 billion Belarusian rubles, amounting as at the end of 2007 to 9.8 percent of the total debt under credit. Problem debt under banks’ financial leasing operations declined during 2007 by 65.0 percent to 2.7 billion Belarusian rubles, amounting to 0.4 percent of clients’

total debt to banks under financial leasing operations. As at the end of 2007, six banks had problem debt under financial leasing operations, one bank accounting for 91.6 percent of its amount.

Banks engaged in financial leasing operations mainly in foreign exchange. The share of debt in foreign exchange under financial leasing in the total amount of banks' debt under financial leasing amounted to 75 percent as of January 1, 2008 (as of January 1, 2007 it was 63.6 percent). This gives grounds to assume that in the segment of leasing operations as a whole, the share of leasing operations in foreign exchange can also be significant. Correspondingly, leasing companies formally transfer foreign exchange risks to their clients. But, in fact, capacity of lessees to repay foreign exchange obligations can be assured only if they have stable sources of foreign exchange proceeds. If such sources are non-existent, then in case of unfavorable and unexpected for the lessees exchange rate changes the risk of untimely lease payments can increase jeopardizing financial stability of leasing companies.

At the same time, risks associated with leasing operations seem to be limited for the banking sector as a whole owing to the insignificant share of such operations in banks' asset operations. For example, in 2007, the amount of banks' financial leasing operations was 2.7 percent of banks' long-term credits, or 1.1 percent of the total amount of extended credits.

PAYMENT SYSTEM OF THE REPUBLIC OF BELARUS

Table

MAIN RESULTS

of assessment of the payment system of the Republic of Belarus as to its compliance with the Core Principles for Systemically Important Payment Systems

Category of assessment	Core principles by category of assessment	
Complied with	CP I CP II CP IV CP VI CP IX Responsibility D	<p>The system should have a well-developed legal basis.</p> <p>The system's rules and procedures should enable participants to have a clear understanding of the system's impact on each of the financial risks they incur due to the participation in it.</p> <p>The system should provide prompt final settlement as at the end of the day.</p> <p>Assets used for settlement should bear an insignificant or zero credit risk and liquidity risk.</p> <p>The system should have objective and publicly disclosed criteria for participation, which ensure a fair and open access.</p> <p>When ensuring the safety and efficiency of the payment system by applying the Core Principles the central bank should cooperate with other central banks and authorities.</p>
Generally complied with	CP III CP VII CP VIII CP X Responsibility A	<p>The system should have clearly defined risks management procedures.</p> <p>The system should ensure a high degree of security and reliability and have contingency arrangements for timely completion of daily payments processing.</p> <p>The methods of payments should be practical for its users and efficient for the economy.</p> <p>The procedures for managing the system should be efficient, accountable and transparent.</p> <p>The central bank should clearly define its objectives regarding the payment systems and disclose to the public its role and major policies with respect to the systemically important payment systems.</p>

Source: developed based on the NBRB, IMF data.