



REPUBLIC OF BELARUS

September 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF BELARUS

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2016 Article IV consultation with the Republic of Belarus, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 2, 2016 consideration of the staff report that concluded the Article IV consultation with the Republic of Belarus.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 2, 2016, following discussions that ended on July 1, 2016, with the officials of the Republic of Belarus on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 9, 2016.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for the Republic of Belarus.

The documents listed below have been or will be separately released.

Financial Stability System Assessment

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: <http://www.imf.org>
Price: \$18.00 per printed copy

International Monetary Fund
Washington, D.C.



INTERNATIONAL MONETARY FUND



Press Release No. 16/143
FOR IMMEDIATE RELEASE
September 21, 2016

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2016 Article IV Consultation with the Republic of Belarus

On September 2, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the 2016 Article IV consultation¹ with the Republic of Belarus.

Economic conditions in Belarus were volatile during much of 2015 and early 2016. The economy contracted by 3.9 percent in 2015, with a similar performance in the first half of 2016, hurt by domestic structural weaknesses and rigidities as well as external shocks. The exchange rate depreciated sharply during 2015 and part of 2016. Real wages are down substantially relative to 2014, and corporate losses are up. Unemployment has risen somewhat, though remains at relatively low levels.

Tighter fiscal and monetary policies during much of 2015–16 have helped support macroeconomic stabilization. The exchange rate has now stabilized and international bond spreads have narrowed. Since the shift to a more flexible exchange rate regime in early 2015, reserves have stabilized and, in recent months, begun to rise. The current account deficit is up slightly this year, but down sharply from the level of several years ago. Headline inflation has slowed in recent months, despite a sizeable hike in regulated utility tariffs in early 2016.

Vulnerabilities remain elevated. Credit to the private sector has slowed and banks' asset quality and profitability have weakened. This, together with a slow resolution of troubled loans, has resulted in rising non-performing loans. Systemic liquidity risks are elevated as banks are highly dollarized and carry an asset-liability mismatch in some key foreign currencies. Public debt has risen, in spite of headline surpluses, in part due to rising realized losses in the state-owned enterprise sector. External debt has also risen, and reserves remain low by international standards.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

The economy is expected to contract further this year and next, reflecting still-weak balance sheets and structural impediments. A subdued recovery is expected as of 2018, while over the medium-term the potential growth would only increase to around 1¾ percent, limited by negative demographics and, in the absence of deeper structural reforms, low productivity growth. Inflation is expected to gradually fall to the high single digits over the next few years.

Key domestic risks to the outlook include the pace of implementation of the policy reform agenda and uncertainties about the size of quasi-fiscal liabilities. On the external side, key risks include persistently lower international energy prices or disruptions in energy price arrangements with Russia. Corporate and bank balance sheets and household confidence remain sensitive to any significant exchange rate movements, owing to high dollarization, currency mismatches, limited access to foreign exchange liquidity, and significant annual gross external financing requirements.

Executive Board Assessment²

Executive Directors welcomed the measures taken by the authorities since early 2015 to stabilize the economy and begin implementing institutional and structural reforms, in a context of difficult economic conditions. Directors underscored, however, that sustained and far-reaching reforms are needed to reduce macrofinancial vulnerabilities, rebuild buffers, and raise economic growth and jobs prospects.

Directors highlighted the importance of deeper reforms to unlock growth potential. They urged implementation of a comprehensive reform strategy for state-owned enterprises to improve productivity and efficiency and reduce fiscal risks. This should include stronger corporate governance and oversight and clearer mechanisms for addressing problem entities. They also recommended identifying clear, evenly paced measures to achieve full cost recovery in the utility sector by end-2018. Directors stressed that improving the business environment, including through pursuit of WTO membership and steps to enhance product market competition, will be crucial.

Directors encouraged the authorities to continue their efforts to strengthen the fiscal framework. They noted that some easing is possible in the near term, given the deep recession and negative output gap. This should be followed by a gradual medium-term fiscal consolidation to reduce public debt while preserving space for enhanced social safety nets and capital expenditure. They stressed the need to strengthen the debt anchor by encompassing government guarantees and local government debt. They also recommended reflecting in the budget all quasi-fiscal support to enhance transparency. Further pension reforms will also be important.

² At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

Directors urged a cautious monetary policy stance to preserve macroeconomic and financial stability, including a tightening of monetary aggregates if needed. They welcomed the authorities' plans to gradually transition from quantitative targeting to inflation targeting in the medium term. They underscored the importance of continuing to phase out directed lending and price controls and ensuring that the prudential limits on interest rates are temporary. They supported efforts to strengthen the central bank's operational capacity and independence, including through clarification of the primacy of price stability. Directors also welcomed the elimination of multiple currency practices and the shift to a more flexible exchange rate. They stressed the importance of maintaining exchange rate flexibility and rebuilding external buffers as conditions allow.

Directors encouraged the authorities to implement the recommendations of the Financial System Stability Assessment, including transitioning to independent and risk-based oversight of the financial sector, implementing a comprehensive resolution strategy for nonperforming loans combined with corporate restructuring, strengthening macro-prudential policies to mitigate foreign exchange liquidity risks from dollarization, and designing a well-functioning financial safety net. They urged follow up on any shortcomings identified by the asset quality reviews of major banks. Directors emphasized that the Development Bank should maintain a limited and well-targeted role.

Directors noted the authorities' interest in a Fund-supported program and underscored the importance of strong commitment at the highest level to consistent macroeconomic policies and deep, market-oriented reforms.

Belarus: Selected Economic Indicators (Baseline), 2014–21

	2014	2015	2016	2017	2018	2019	2020	2021
			Proj.					
	(Percentage change)							
National accounts								
Real GDP	1.7	-3.9	-3.0	-0.5	0.5	1.0	1.3	1.8
Total domestic demand	0.3	-6.3	-9.7	-3.6	-0.8	0.1	0.3	1.3
Consumption	3.2	-2.0	-3.9	0.4	1.3	1.7	1.3	2.0
Nongovernment	4.3	-2.4	-2.5	0.4	1.5	1.7	1.4	2.4
Government	-2.0	-0.4	-11.0	0.2	0.2	1.3	0.9	-0.2
Investment	-5.0	-15.2	-23.4	-15.7	-8.2	-5.7	-3.9	-1.9
Net exports 1/	1.2	5.3	5.0	1.7	1.3	0.8	1.0	0.5
Consumer prices								
End of period	16.2	12.0	13.0	11.0	10.0	9.0	9.0	9.0
Average	18.1	13.5	12.7	12.0	9.7	9.3	8.9	9.0
GDP deflator	17.8	16.3	13.0	8.7	8.9	8.3	8.6	8.7
Monetary accounts								
Rubel base money	12.8	7.4	2.5	13.3	12.8	12.5	10.6	10.0
Broad money	23.6	36.8	15.0	13.5	12.5	11.0	10.5	10.0
	(Percent of GDP, unless otherwise indicated)							
External debt and balance of payments								
Current account balance	-6.9	-3.8	-4.9	-4.8	-4.4	-4.2	-3.7	-3.3
Trade balance	-3.5	-3.9	-6.6	-5.7	-5.3	-4.9	-4.2	-4.0
Exports of goods	46.5	48.0	47.9	50.4	50.2	50.1	49.8	49.6
Imports of goods	-50.0	-51.9	-54.5	-56.1	-55.5	-55.0	-54.0	-53.5
Gross external debt	53.4	69.9	81.8	82.7	81.4	80.1	77.8	74.0
Public 2/	23.9	31.7	38.3	41.7	40.2	39.5	38.4	36.0
Private (incl. state-owned-enterprises)	29.5	38.2	43.5	41.1	41.2	40.5	39.4	38.0
Net IIP	-55.0	-75.0	-88.5	-90.2	-90.9	-92.2	-91.9	-90.1
Savings and investment								
Gross domestic investment	35.6	30.0	26.9	23.6	21.8	20.5	19.4	18.7
Government	5.3	4.5	5.5	6.9	6.8	6.7	6.6	5.7
Nongovernment (incl. SOEs)	30.2	25.5	21.3	16.7	15.0	13.8	12.8	12.9
National saving 3/	28.7	26.2	21.9	18.8	17.4	16.3	15.7	15.3
Government	2.9	7.2	6.8	8.2	8.6	8.9	8.6	8.6
Nongovernment	25.8	19.0	15.1	10.5	8.8	7.3	7.2	6.7
Public sector finance								
State budget balance	0.7	2.3	-1.5	-3.1	-3.0	-3.0	-2.8	-1.5
State budget balance (excl. nuclear power plant, "NPP")	0.7	2.6	0.3	0.4	0.4	0.3	0.4	0.8
General government balance (incl. SPF)	0.7	1.9	-1.9	-3.6	-3.3	-3.3	-3.1	-1.8
Primary general government balance	2.0	3.6	0.4	-1.0	-0.5	0.1	0.5	1.8
Primary general government balance (excl. NPP)	2.0	4.0	2.3	2.6	2.9	3.4	3.8	4.2
Cyclically adjusted primary balance 4/	-1.4	5.7	4.2	5.6	5.6	5.3	5.1	4.7
Overall balance 5/	0.0	-1.5	-2.8	-6.5	-6.2	-6.1	-6.0	-4.7
Gross general government debt and guaranteed debt 6/	37.3	53.7	54.9	59.2	62.8	65.7	68.2	69.2
Of which: Public guarantees	12.5	14.5	14.5	14.5	14.5	14.5	14.5	14.5
Memorandum items:								
Nominal GDP (billions of U.S. dollars)	76	55	48	50	52	54	56	59
Nominal GDP (trillions of BYR)	778	870	953	1,031	1,129	1,235	1,359	1,504
Terms of trade, percentage change	2.2	-11.9	-8.9	-1.2	-1.2	-1.0	-0.7	-0.4
Real Effective Exchange Rate ("-" denotes a depreciation)	8.5	-9.2						
Nominal Effective Exchange Rate ("-" denotes a depreciation)	-3.8	-12.6						
Official reserves (billions of U.S. dollars)	5.1	4.2	4.2	4.5	4.4	4.4	4.5	4.6
Months of imports of goods and services	1.9	1.7	1.6	1.6	1.6	1.5	1.5	1.5
Percent of short-term debt	37.2	35.4	36.0	38.6	37.1	36.0	36.7	36.3
Quota (2016): SDR 681.5 million (950.8 million U.S. dollars)								

Sources: Belarusian authorities; and IMF staff estimates.

1/ Contribution to growth.

2/ Gross consolidated external debt of the public sector (central bank and general government debt including publicly guaranteed debt).

3/ The reduction in government saving and a corresponding increase in nongovernment saving include bank recapitalization and layouts related to public guaranteed debt.

4/ The augmented balance adds to the balance of the general government outlays for called guarantees of publicly guaranteed debt.

5/ Includes general government and off balance sheet operations.

6/ Consolidated debt of the non-financial public sector (general government debt including publicly guaranteed debt).



REPUBLIC OF BELARUS

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

August 9, 2016

KEY ISSUES

Context: The economy is contracting, hurt by external shocks and domestic structural weaknesses and rigidities. The authorities have taken some positive steps, including policies supporting macroeconomic stabilization and structural and institutional reforms such as a shift to a more flexible exchange rate. However, external sector weaknesses and negative macrofinancial feedback loops centered around the deteriorating performance of state owned enterprises (SOEs) are pushing up public and external debt, weakening the financial sector, and threatening stability.

Policy recommendations: *A comprehensive, well-coordinated policy package is needed to support macroeconomic stability, reduce vulnerabilities, and unlock growth potential.*

- *Real sector.* Increase efficiency, market orientation, and competitiveness, and reduce quasi-fiscal drains by: (i) developing and implementing a comprehensive SOE reform strategy that strengthens monitoring and diagnostics, phases out production targets, scales down government directed lending, and strengthens corporate governance; (ii) implementing well-specified measures to achieve full utility cost recovery by the end of 2018; and (iii) strengthening the business environment.
- *Fiscal policy.* Strengthen and recalibrate fiscal policy by: (i) supporting well-targeted social safety nets (SSNs) and preserving capital expenditures; (ii) bringing state support on budget and quasi-fiscal loss estimates into debt projections; and (iii) medium-term fiscal consolidation to safeguard debt sustainability and support external adjustment, including via wage restraint.
- *Monetary and exchange rate policy.* Facilitate stabilization and adjustment by: (i) maintaining a monetary policy stance consistent with reducing inflation—while safeguarding financial and external stability; (ii) gradually transitioning from monetary aggregate targeting to inflation targeting; and (iii) maintaining exchange rate flexibility while seeking opportunities to rebuild reserves.
- *Financial sector policy.* Strengthen financial sector stability and market orientation (drawing on recommendations of the recent FSAP and results of bank diagnostic studies) by: (i) cleaning up balance sheets and strengthening resilience of banks, including by rebuilding FX liquidity buffers; (ii) strengthening financial sector frameworks, including for NPL resolution and shifting to risk-based oversight; (iii) delimiting the Development Bank's activities to efficiently addressing market failures in priority policy areas, and (iv) employing macroprudential measures to contain FX liquidity risks from dollarization.

Approved By
**James Gordon and
 Mark Flanagan**

Discussions for the 2016 Article IV Consultation were held in Minsk during June 20—July 1. The mission comprised Messrs. Dohlman (head) and Shahmoradi, and Ms. Jajko (all EUR), Mr. Moore (SPR), Ms. Liu (FAD), and Ms. Ogawa (MCM). Mr. Bakker (Sr. Regional Res. Rep.) and Mr. Misyukovets (OED) joined part of the discussions. The mission met with Prime Minister Kobyakov, Deputy Prime Minister Matyushevsky, Minister of Economy Zinovskiy, Minister of Finance Amarin, Central Bank Governor Kallaur, other senior officials and representatives of government, financial institutions, the private sector, and civil society. Mr. Jovanovic and Ms. Madaraszova contributed to the preparation of this report.

CONTENTS

CONTEXT	4
RECENT DEVELOPMENTS	6
OUTLOOK AND RISKS	7
POLICY DISCUSSIONS	9
A. Structural Reforms: Unlocking More Market-Oriented Growth Potential	9
B. Fiscal Policy: Strengthening and Recalibrating	12
C. Monetary and Exchange Rate Policy: Maintaining Stability	15
D. Financial Sector: Bolstering Stability and Market-Based Lending	18
STAFF APPRAISAL	20
BOXES	
1. From Extensive to Intensive Growth	22
2. External Stability Assessment	23
3. Baseline and Adjustment Scenarios, 2016–21	24
4. Utility Tariffs and Cost Recovery	25
5. Pension System Sustainability and Reform Options	26
6. FSAP Key Findings and Recommendations	27
FIGURES	
1. Economic and Financial Linkages with Russia and ROW, 2005–21	28
2. Real Sector Developments, 2002–16	29
3. Corporate Sector Developments, 2006–16	30
4. Inflation Developments, 2007–16	31

5. External Sector, 2000–16	32
6. Structural Developments, 2008–15	33
7. Fiscal Developments, 2000–16	34
8. Monetary Developments, 2011–16	35
9. Financial Sector Developments, 2011–16	36
10. Baseline and Adjustment Scenarios, 2013–21	37
11. Baseline and Adjustment Scenarios, 2013–21	38

TABLES

1a. Selected Economic Indicators (Baseline Scenario), 2014–21	39
1b. Selected Economic Indicators (Adjustment Scenario), 2014–21	40
2. Balance of Payments (Baseline), 2014–21	41
3. Fiscal Indicators and Projections (Baseline), 2014–21	43
4. Monetary Accounts (Baseline), 2014–2021	45
5. Financial Soundness Indicators, 2010–2016	46

ANNEXES

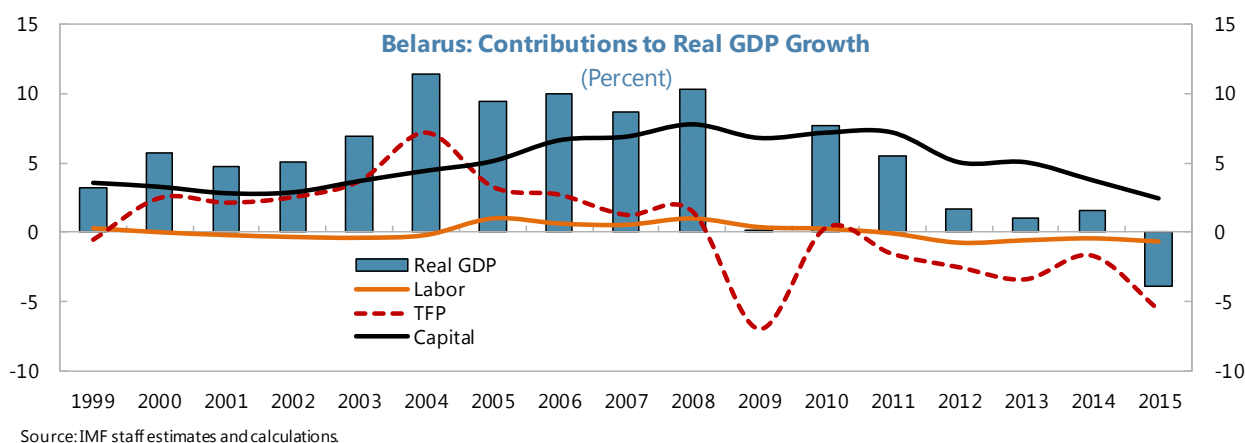
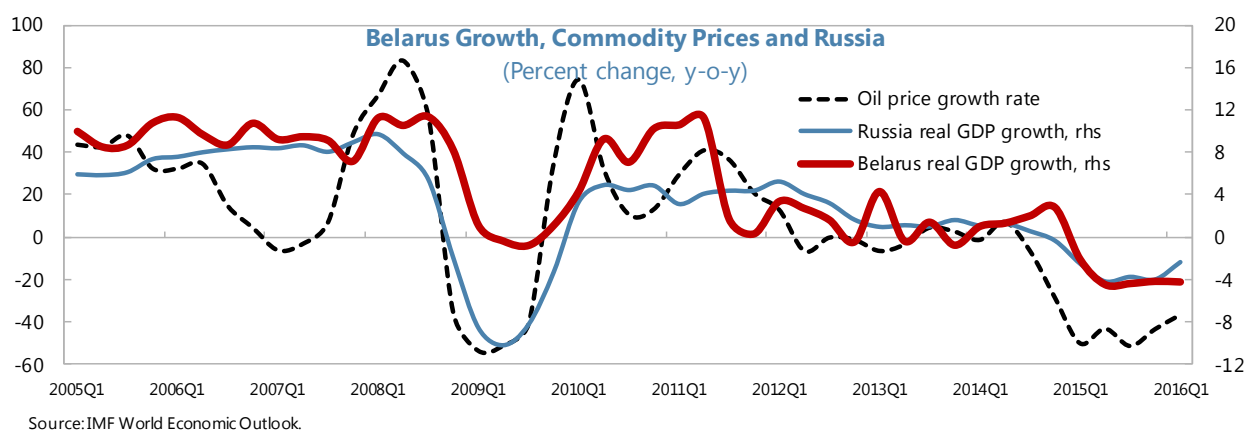
I. Responses to Past Policy Recommendations	47
II. Public and External Sector DSAs (Baseline Scenario)	49
III. Risk Assessment Matrix	52
IV. Measures Affecting Interest Rates and FX Demand	53

APPENDICES

I. Public Sector Debt Sustainability Analysis (DSA)-Baseline Scenario	58
II. Public DSA-Composition of Public Debt and Alternative Scenarios	59
III. Public DSA-Stress Tests	60
IV. External Debt Sustainability Framework (Baseline) 2011-21	61
V. External Debt Sustainability: Bound Tests	62

CONTEXT

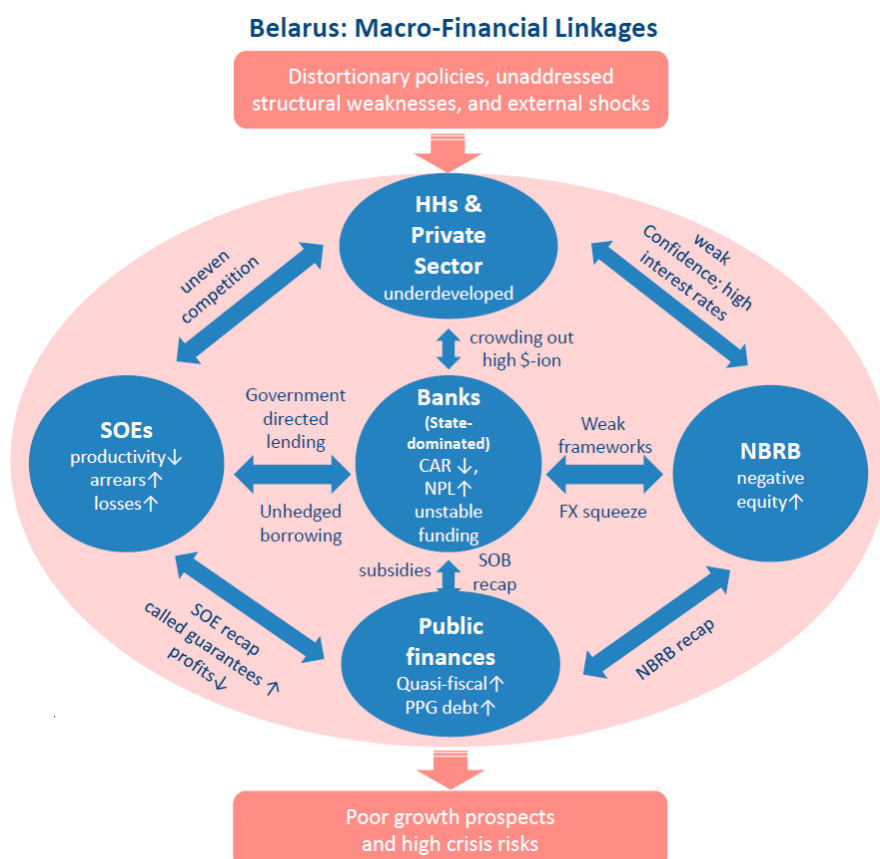
1. The economy is suffering from deep recession. External shocks, including low oil prices and the downturn in Russia, have exposed deep domestic structural problems, reflected in falling productivity (Box 1). Policies during 2015–16 have supported macroeconomic stability and have begun to address long-standing structural weaknesses discussed in past consultations (Annex I). But vulnerabilities are increasing faster, marked by rising public and external debt (Annex II), weakening corporate and bank balance sheets, and low reserves. Most senior officials agree that deep institutional and structural reforms are needed, but express concern about their social impact and about the government’s implementation capacity in areas such as SOE reform. Some official sector stakeholders believe that the recession is due to ‘temporary’ external shocks and high interest rates and argue that the new 2016–20 Government Action Plan is sufficient to revive growth prospects.



2. Belarus has responded to past pressures with episodes of tight macroeconomic policies, with structural weaknesses left largely unaddressed. In response to past macroeconomic and financial pressures, the authorities tightened fiscal policy, restrained wages, allowed exchange rate adjustment, and took some structural measures—mainly in the financial sector as well as limited privatizations. But policies tended to relax after immediate pressures

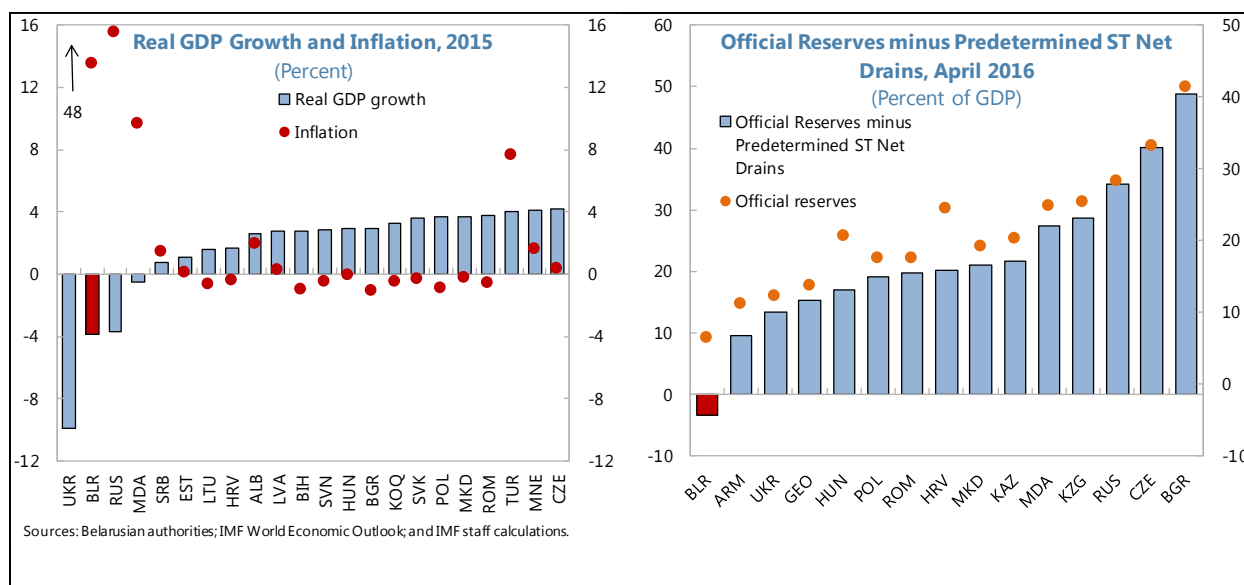
abated, and deeper-rooted vulnerabilities persisted. In addressing the most recent economic downturn, the authorities have undertaken more sustained stabilization efforts and demonstrated stronger ownership of reforms. These include initiation of some significant measures to address underlying vulnerabilities, though overall progress is still at an early stage and future reversals cannot be ruled out.

3. Belarus is seeking to deepen and diversify its external economic relations. Economic ties with Russia remain strong (Figure 1), including through membership in the Eurasian Economic Union (EEU), though disagreements over the pricing of energy imports from Russia are coloring these good relations and creating risks. Belarus is also seeking to strengthen other external economic linkages by leveraging its proximity to the European Union (EU) and growing ties with China. The EU recently lifted most sanctions on Belarus, unlocking potential loans from the European Bank for Restructuring and Development (EBRD) and European Investment Bank (EIB). Belarus is a key way station on the China-led new Silk Road, bringing additional financial and logistics resources to the economy. Belarus has revived WTO negotiations and intensified relations with International Financial Institutions (IFIs). The World Bank is considering a policy loan.



RECENT DEVELOPMENTS

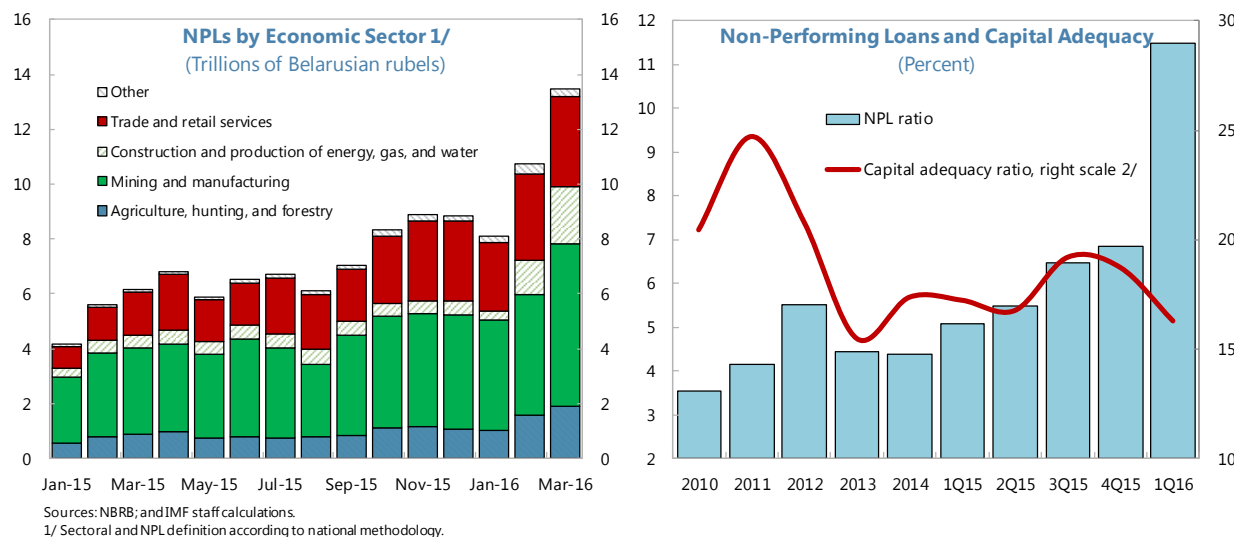
4. The economy continues to contract (Figures 2–4; Table 1A). Real GDP contracted by nearly 4 percent in 2015, with signs of similar decline in the first half of 2016. Headline inflation has slowed in recent months, but remains high relative to peers at 12.1 percent y-o-y as of end-June 2016 (text chart). Real wages are down and unemployment is rising amid corporate losses and weakening balance sheets. Negative macro-financial feedback loops are taking their toll, with implications for quasi-fiscal liabilities emanating from state-owned banks and the SOE sector.



5. The external sector remains fragile with diminished buffers. (Figure 5; Table 2). The Belarusian ruble (BYR) lost 36 percent of its value against the USD (28 percent against a trade weighted basket) in 2015, and a further 7½ percent against the USD through end-June 2016. The current account deficit narrowed to 3.8 percent of GDP in 2015, amidst sharp import compression and retention of energy export duties formerly repaid to Russia, but staff estimates the BYR remains up to 10 percent overvalued (Box 2). Gross official reserves (US\$4.3 billion at end-June 2016) are well below standard adequacy metrics. Official reserves net of predetermined short-term net FX drains are negative (text chart), reflecting significant FX-denominated domestic and foreign debt. Further erosion in reserves has been avoided only by foreign exchange borrowing from Russia (US\$0.8 billion) and the Eurasian Fund for Stabilization and Development ('EFSD', US\$2 billion committed). Despite this, spreads on Belarusian 2018 Eurobonds have halved from 1,000 bps in mid-2015 to around 450 bps in July, roughly in line with similarly rated peers—reflecting a strong repayment track record as well as credibility gains from stronger policies.

6. The banking system faces significant challenges. (Text chart). Capital adequacy ratios are falling and non-performing loans (NPLs) are rising. NPLs are likely underestimated given regulatory

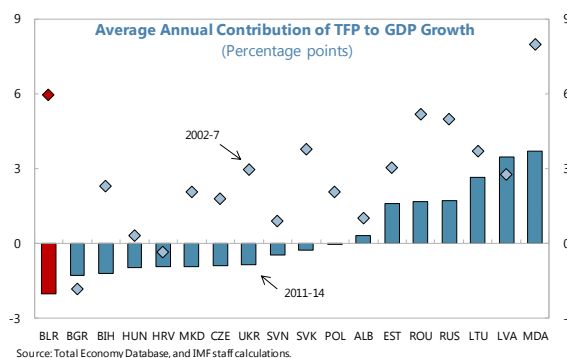
forbearance, evergreening, and diminished real sector repayment capacity, particularly among SOEs. Bank profitability is being squeezed. Deposits have stabilized after a period of erosion that was likely driven by depreciation and consumption smoothing. Banks also face significant challenges adjusting to cuts in government directed lending and guarantees. Given the significant state presence in the banking sector (state-owned banks account for about 65 percent of the banking system assets), any needed recapitalization relating to the state bank-SOE nexus has implications for the budget.



OUTLOOK AND RISKS

7. Belarus’s near-term macroeconomic outlook is further contraction and persistent elevated inflation (Box 3).

- Growth** is expected to remain negative this year (-3.0 percent) and next (-0.5 percent) under staff’s baseline (partial adjustment) scenario, with a subdued recovery beginning in 2018 (+0.5 percent). Recovery will lag that in Russia given weaker balance sheets and structural impediments in Belarus. Real GDP will gradually rise to a potential growth rate of slightly above 1¾ percent, taking into account TFP trends and negative demographics. Under staff’s adjustment scenario, deeper and faster reforms would initially push growth lower, mainly due to lower domestic demand, but productivity gains and rising domestic demand would then drive growth up to 4½ percent during 2020–21 before settling into a 3½ percent long-term potential growth rate.



- **Inflation** is expected to reach 13 percent y-o-y by end-December—almost 1 percentage point higher than last year—driven mainly by recent exchange rate depreciation and higher utility tariffs. Inflation is projected to remain in the low double digits over the next three years under the baseline scenario. Better policy implementation under the adjustment scenario would bring inflation down to around 6 percent by 2020.
- **The current account deficit** is projected to widen by about 1 percent of GDP this year and then narrow gradually in the medium term to 3–3½ percent under the baseline scenario. Under the adjustment scenario, the current account deficit would significantly narrow to around ½ percent of GDP by 2021, with higher reserve build-up. This reflects significant reforms, including to SOEs, that could sustainably lower import demand and promote higher FDI and other capital inflows.

8. Risks are tilted to the downside (Risk Assessment Matrix, Annex III). Belarus is prone to external and domestic shocks and swings in confidence that macro-financial linkages could propagate into crisis. Lower (higher) energy prices would erode (boost) growth and external stability. Current energy price disagreements with Russia, if not resolved, could disrupt external and domestic stability. In the event of significant renewed depreciation, corporate and bank balance sheets and household (HH) confidence would weaken owing to high dollarization, currency mismatches, limited access to foreign exchange liquidity, and significant annual gross external financing requirements in the range of US\$18 billion (35 percent of GDP). Risks to balance sheets would be heightened in the event of slippages in domestic policy implementation. Quasi-fiscal liabilities are particularly uncertain and could be higher (or lower) than estimated.

Authorities' Views

9. The authorities noted that external conditions have recently improved and their stabilization and structural reform policies are bearing fruit. They expect the economic contraction to ease more rapidly in 2016—with some in government expecting a return to growth—and inflation to fall by more relative to staff's baseline projections. They pointed to a number of important recent reforms, including the shift to a flexible exchange rate regime, price liberalization, and some SOE reforms.

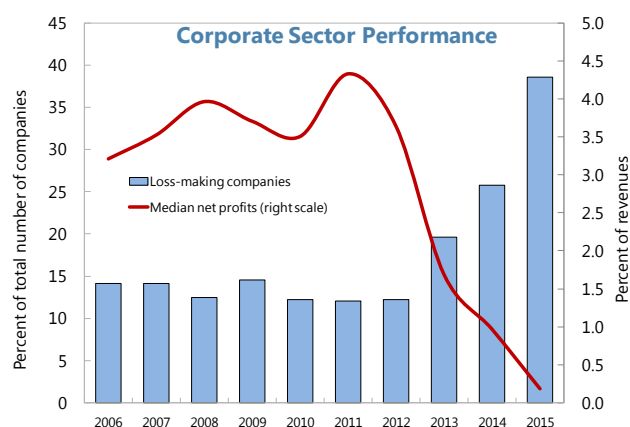
10. The authorities are more upbeat about medium-term economic prospects. They expect much higher medium-term growth in the range of 5 to 6 percent. The authorities expressed greater optimism about reform implementation and anticipated higher investment than under staff's baseline scenario. They expect stronger external sector performance, helped by expected lower energy import prices from Russia but also higher foreign direct investment and strengthened competitiveness. They noted the challenges (and benefits) of increased competition from globalization, and remain firmly committed to both deeper external economic ties as well as to policies consistent with maintaining social stability. They broadly agreed with the range of risks identified by staff, but see their policies, taken together, as significantly contributing to risk mitigation. They expect quick resolution of the energy pricing issue with Russia and view the risk of persistently lower oil prices as somewhat less likely. They see lower risks from the SOE sector, having provided substantial support to SOEs in 2015 and taken some measures to improve SOE soundness.

POLICY DISCUSSIONS

11. Discussions covered the macroeconomic, financial, and structural policies needed to support stability, reduce vulnerabilities, and strengthen economic growth and income prospects. Staff recognized that some important stabilization and reform measures have already been taken, but urged additional front-loaded and deeper structural measures to: (i) mitigate significant and rising risks to sovereign, financial sector, and external stability; (ii) achieve higher sustainable levels of medium-term growth and income; and (iii) provide well-funded and targeted SSNs to mitigate the impact of reforms.

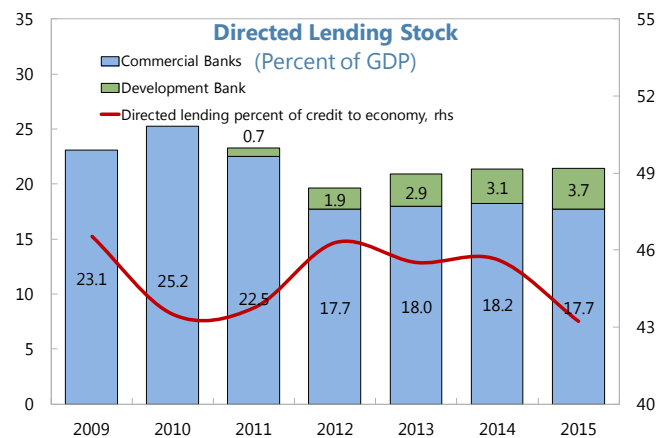
A. Structural Reforms: Unlocking More Market-Oriented Growth Potential

12. Government-dominated economic activity is increasingly inefficient, creating a drag on growth. Overall productivity is down and many corporates, including SOEs, are now generating substantial losses (text chart). Various forms of state support and involvement distort economic activity or create an uneven playing field for the private sector. Examples include implicit production targets for some SOEs (the state accounts for around 50 percent of employment and gross value added in the economy), lingering price controls, and subsidized government directed lending. Directed lending accounts for almost 40 percent of all loans, largely FX-denominated investment loans from state-owned banks to unhedged SOEs that have broadly fallen short of generating intended improvements in productivity and competitiveness. Such lending has also hindered the development of bank risk assessment capacity.



Sources: Ministry of Finance of the Republic of Belarus.

13. The authorities are developing a comprehensive SOE strategy, and have begun implementing some important SOE diagnostics and reforms. During 2015–16, a government working group assessed repayment capacity of SOEs with the largest FX-denominated liabilities, and provided guidance on where restructuring or insolvency could be needed. Relatedly, the government has initiated a phased reduction in directed lending. More recently, the authorities have been compiling a comprehensive inventory of SOEs with key financial and employment indicators, and published their first SOE monitoring report. They have taken steps to strengthen SOE



Sources: Belarusian authorities; and IMF staff calculations.

governance, including a recent decree that separates regulatory oversight and ownership and establishes independent supervisory boards. Another recent decree has replaced production targets with objectives of profitability, efficiency, and export competitiveness, though there is evidence that some SOEs are still receiving production target instructions from line ministries. The authorities report that some small SOEs are being prepared for privatization. Looking ahead, they hope to attract minority-stake strategic investors for large SOEs, and pursue a mixture of ongoing operations, restructuring, insolvency, and privatization for other SOEs. In terms of tangible results, employment in larger SOEs has fallen about 12 percent over the past two years, but few SOEs have entered insolvency or been privatized.

14. Some other important real sector reforms are also underway:

- **Price liberalization.** Price controls were reduced from 28 to 18 percent of the CPI basket, down from 49 percent in 2011. Price ceiling controls remain on pharmaceuticals and some staples, as well as a price floor on vodka.
- **Rationalization of HH utility tariffs.** (Box 4). HH utility tariff increases in early 2016 raised utility cost recovery by an average of nearly 10 percentage points, reaching about 58 percent. The authorities are not planning further HH tariff hikes this year, but have committed to a mix of tariff hikes and cost reduction (particularly in the heating sector) to achieve 75 percent cost recovery in 2017 and 100 percent cost recovery by 2018. However, at present the authorities' plans lack sufficient detail to be credible—particularly with respect to expected cost reductions. They plan to launch a better-targeted social support mechanism this year to help offset the impact tariff hikes on HHs.
- **Improvements in the business climate.** (Figure 6). The authorities have achieved some progress in Doing Business indicators, having reduced administrative and licensing procedures for businesses and simplified startup, tax administration, and ownership registration procedures. Progress has also been made in reducing the tax burden on businesses. The government recently expanded the mandate of the Trade Ministry to include antimonopoly enforcement (aiming to ensure a more competitive environment where needed).

Staff Recommendations

15. Staff encouraged the authorities to accelerate and deepen structural reforms. Staff argued that more comprehensive, deeper, and faster reforms are needed to improve resource allocation and competitiveness, to reduce fiscal, banking, and external risks, and to support higher sustainable growth.

- **Deeper SOE reform.** The mission supported plans for a comprehensive SOE strategy, while stressing the overarching goal of greater market orientation and efficiency. Drawing on recent FAD TA, staff urged the authorities to: (i) establish a fiscal risk monitoring unit tasked to carry out a comprehensive review of fiscal risks emanating from the SOE sector on an ongoing basis; (ii) undertake an in depth inventory of SOEs to determine which carry out commercial as opposed to

government functions; (iii) incorporate all commercial enterprises; (iv) implement legislation requiring all key SOEs to adopt International Financial Reporting Standards (IFRS); (v) further strengthen SOE corporate governance, including by implementing the policy to separate ownership and regulatory functions through centralizing ownership in a single coordinating entity and strengthening the independence and capacities of SOE boards; and (vi) enhance and strengthen the framework for restructuring SOEs, including by developing clear insolvency and privatization criteria and procedures. The mission also urged close coordination of SOE restructuring with financial sector reforms, notably treatment of bad loans, and stronger SSNs.

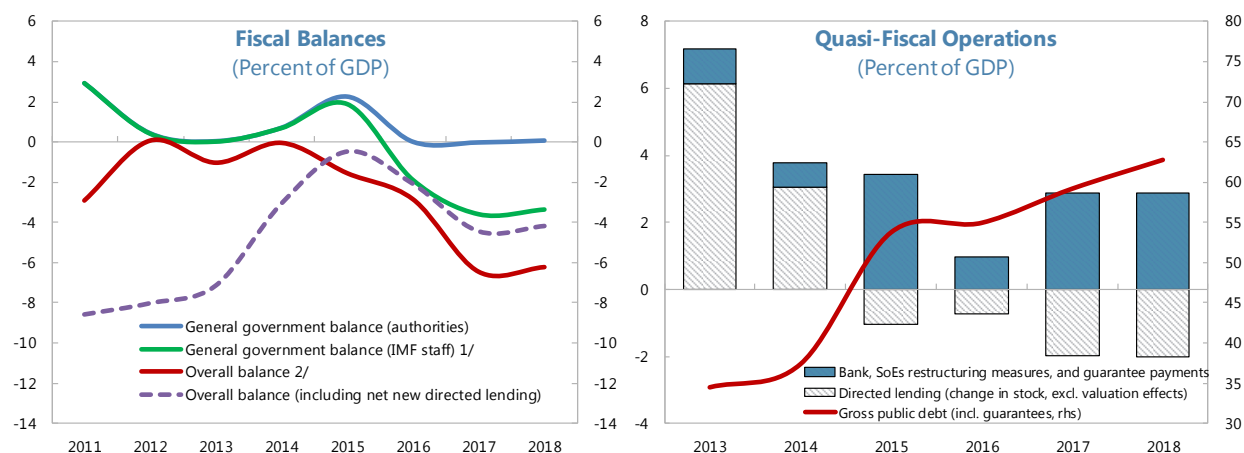
- **Rationalization of the utility sector.** Staff supported the authorities' plans to improve utility cost efficiency, but noted that further significant HH tariff hikes are unavoidable to achieve the government's objective of 100 percent cost recovery by 2018. Staff urged adoption of clear, time-bound measures with contingencies should cost reduction efforts fall short. Increases in cost recovery levels should be matched by pro rata reductions in budget and industry cross-subsidies, coupled with better funded and well-targeted SSNs to protect the most vulnerable. The cost recovery program should also include a clear framework to take into account changes in international gas prices and exchange rates. Once full cost recovery is reached, a clear mechanism for maintaining full cost recovery should be employed.
- **Strengthening competition policies and the business climate.** Staff supported the objectives of the new antimonopoly agency, and urged a close look at product market liberalization, including in SOE-dominated sectors such as transportation and agriculture. Staff also urged prioritizing WTO accession negotiations, which could provide a key anchor for structural reforms.

Authorities' Views

16. The authorities agreed on the need for further structural reforms, but are still considering the most effective path forward. They are now assessing the findings of the recent IMF TA mission on SOE reform and recommendations from other international partners, aiming to develop a robust SOE reform strategy by 4Q2016. They expressed some concern about implementation capacity and how to best strengthen some key elements of the reform process such as the insolvency process and bad asset management. However, the authorities believe that with their current work plan and further effort to build technical capacity, they will successfully implement a far-reaching restructuring of the SOE sector consistent with greater market orientation and efficiency. Regarding utilities, they noted that firmly addressing inefficiencies and lowering costs were important to help build public support for needed utility tariff hikes, and expressed strong commitment to meet their cost recovery objectives. They agreed that implementing a rules-based utility tariff adjustment mechanism was an important medium-term goal. The authorities also agreed on the importance of WTO membership, including as a driver of reform, but expressed concern that they would be asked to accept less favorable terms than Belarus's EEU partners. They also noted potential benefits from EEU member plans to further harmonize regulatory standards over time.

B. Fiscal Policy: Strengthening and Recalibrating

17. Public debt sustainability risks are rising, despite headline fiscal surpluses. Public debt—including public guaranteed debt (PPG)—has increased significantly from below 40 percent of GDP in 2013 to nearly 54 percent in 2015 (Figure 7; Table 3), owing to sharp depreciation and quasi-fiscal operations, including recapitalizations and called guarantees.¹ Debt is expected to reach nearly 70 percent of GDP in 2021 as quasi-fiscal liabilities are realized.



Sources: National authorities; and IMF staff calculations and projections.

1/ IMF staff includes nuclear power plant in general government.

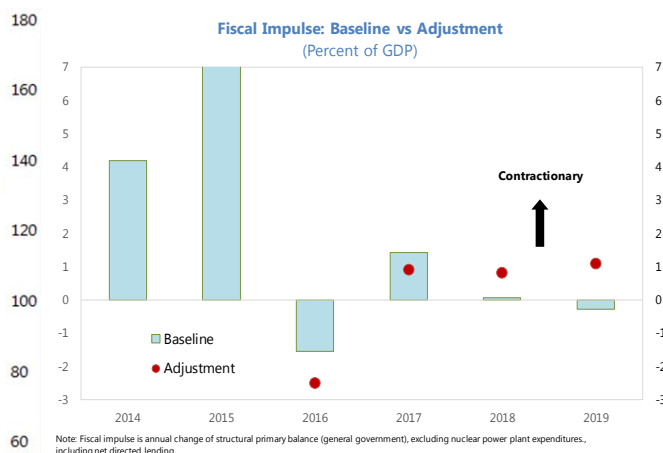
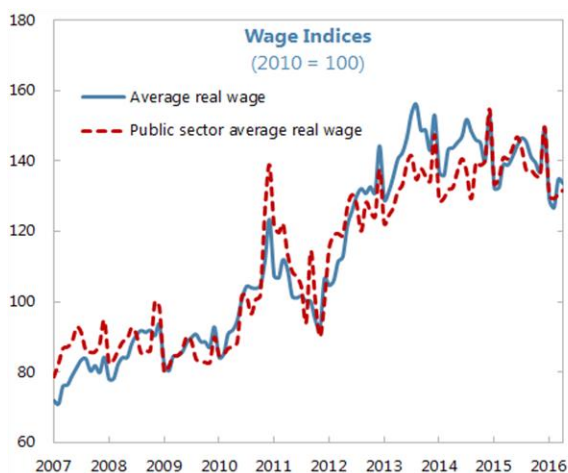
2/ Includes general government and off balance sheet operations.

18. The authorities have tightened fiscal policy and revamped their fiscal framework. Key steps taken by the government in response to deteriorating revenues, external pressures, and mounting debt include:

- **Tightening the 2016 budget.** Export taxes were increased on potash, oil, and fuel. Excise and property taxes were increased and tax expenditure efficiency was enhanced by elimination of preferential VAT tax treatment for transportation and telecommunication sectors. Budget expenditures have been cut, mainly through compression of capital spending and a freeze in real public sector wages that has partially unwound rapid increases in recent years (and helped ease wage pressures in the non-government sector—see text chart). The authorities are also reducing off-balance sheet directed lending. The authorities continue to hold earmarked funds in reserve for strengthened SSNs, including for unemployment benefits and a better-targeted social support mechanism to mitigate HH utility tariff adjustments. The overall fiscal stance is somewhat looser this year, but is expected to tighten next year (text chart).
- **Updating the fiscal framework.** The authorities aim to implement a 3-year budgeting process with strengthened accountability, beginning with the 2017 budget cycle. They have also set up a

¹ There have been two changes in staff's budget calculations: (a) revenues from budgetary funds have been removed from revenue calculations to eliminate double counting; and (b) government net lending is now treated as a financing item rather than part of expenditure.

somewhat complex web of fiscal objectives: (i) a general government balanced-budget—but excluding a new nuclear power plant (NPP) project costing close to 18 percent of GDP over roughly 7 years, financed by Russia; (ii) a medium-term public debt ceiling target of 45 percent of GDP (including the NPP, but excluding guarantees and local government debt); (iii) a prohibition on new issuance of government guarantees (excluding IFIs); (iv) a medium-term objective to



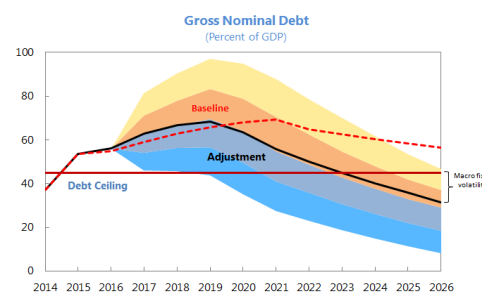
maintain state tax revenues below 26 percent of GDP, which they view as more consistent with peer countries; and (v) reduction of the ratio of FX-denominated public debt service-to-reserves to 45 percent by 2020. These changes follow important tax reforms in recent years, including a unified tax code and harmonization with IFRS.

- **Reforming the pension system and embarking on other medium-term plans.** The authorities recently approved an important parametric pension reform—a gradual increase in retirement ages beginning January 2017—and reindexed pension income to inflation rather than wages (Box 5). Staff expects these measures to broadly maintain fiscal balance of the pension system through 2022. The authorities are also planning further reductions in tax expenditures, drawing on FAD TA, and steps to increase efficiency in goods and service expenditures.

Staff Recommendations

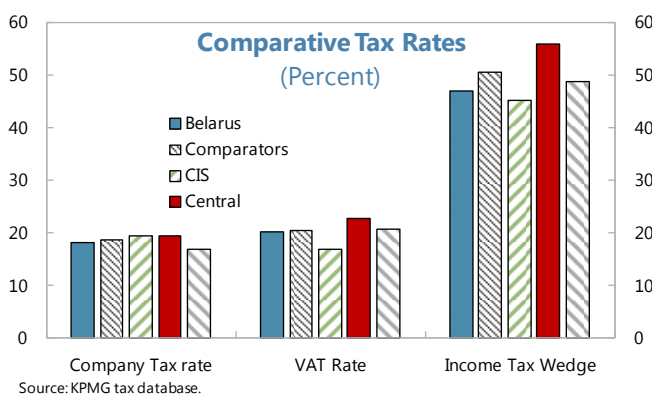
19. Staff urged additional steps to reduce vulnerabilities and support reforms and growth.

- **Strengthen the debt anchor.** Staff supported the debt anchor, but recommended that it be more broadly defined to include guarantees and local government debt. Staff noted that an even lower debt threshold would be advisable given significant risks identified in the public DSA, including a history of large macro-fiscal shocks (text chart), but acknowledged a cushion from significant government cash deposits.



Note: The debt paths of the baseline and adjustment scenarios up to 2021 are from the SEI tables. 2022-2026 debt projections are based on growth with a zero output gap, and constant primary balances and real interest rates as of 2021. The fan chart area is generated assuming realization of a combination of macroeconomic shocks, including shocks to real GDP growth, the real interest rate, the real exchange rate, and the primary balance. The magnitude of the shocks are derived from historical averages, and only the 10 to 90 percentiles of the resulting debt paths are presented.

- Further strengthen the fiscal framework.** Staff supported adoption of medium-term budgeting. To complement the debt anchor, staff urged a more explicit adjustment rule, preferably an expenditure rule based on a broader budget definition (while also looking to simplify the overall set of objectives to enhance communication and credibility). Staff also urged more transparency, including identification and regular monitoring of fiscal risks, explicit recognition of quasi-fiscal liabilities, and bringing all forms of quasi-fiscal government support to the economy on budget. Staff estimates that unrecognized quasi-fiscal liabilities are around 15½ percent of GDP, though this estimate is subject to significant uncertainty. Staff expects to refine these estimates using results from the ongoing bank AQR exercise, and as better SOE performance information becomes available. Staff also pressed the authorities to undertake recapitalization of the central bank (3 percent of GDP) in line with MCM TA.
- Near-term easing, medium-term consolidation.** Some near-term fiscal easing is warranted given recession and a negative output gap, but should be followed by cyclically adjusted fiscal consolidation of about 0.5 percent of GDP annually over the next five years (based on well-specified measures), versus the baseline. With a low fiscal multiplier (about 0.1–0.3 in the first year)², the modest growth impact of the proposed medium-term adjustment can be more than offset by growth enhancing structural reforms. Such measures would bring PPG debt (including NPP) around 55 percent of GDP by 2021, and below the 45 percent target level by 2025.



- Additional revenue and expenditure measures.** Given sustainability concerns, staff recommended that debt reduction be given priority over the aggregate tax revenue burden. Staff recommended low-growth-impact revenue measures, focusing on reducing tax expenditures and if possible, lowering the comparatively high rate of social security contributions (SSCs)—see text chart. Other

Total Fiscal Adjustment, 2016-2021
Adjustment vs Baseline
 (share of GDP)

Measures	Budget Savings 1/
Revenue measures	3.3
Broaden tax base, including reduction of exemptions and removal of preferential regimes	1.3
Higher SOE dividends and SPF contributions, due to SOE reforms	2.0
Primary expenditure measures (excluding NPP)	-0.5
<i>of which:</i>	
Reduce expenditure on goods, services, and non-pension related social spending.	1.3
Higher unemployment benefits	-0.7
Higher in capital expenditures	-1.1
Lower off-balance sheet operations	1.5
Lower directed lending	0.1
Government guarantees	10.9
Zero new gross issuance	10.9
Total	15.3

Source: IMF staff estimate

1/ '+' results in higher budget balance, and lower debt.

² Fiscal multiplier calculation methodology is based on the IMF Guidance Note on Fiscal Multipliers (2013).

possible revenue measures are shown in the text table. On the expenditure side, a sustained effort to limit real public wage growth would provide both fiscal and competitiveness benefits. Capital expenditures should be protected.

- **Additional pension reform:** Staff welcomed the authorities' efforts to reform the pension system. However, staff urged the authorities to: (i) continue reforms to close the pension gap after 2022; (ii) take additional measures to free up fiscal space to lower the burdensome social contribution rate (35 percent); and (iii) take complementary steps to enhance labor participation.

Authorities' Views

20. The authorities viewed their efforts to tighten the fiscal stance in 2016 as sufficient, and were noncommittal regarding additional consolidation measures. They expressed concern about the rapidly increasing debt level, but highlighted that they have adopted several measures to bring debt down to the target level. They plan to include local government debt in their debt target and to reduce issuance of domestic FX-denominated bonds. Regarding realization of quasi-fiscal liabilities, the authorities noted a lack of fiscal resources. They argued that budget resources for SOE and banking sector should not be provided ahead of more fundamental reforms and further clarity about the size of the problem, and that central bank recapitalization could be achieved more gradually. Regarding possible future fiscal measures, they noted that they do not see space to raise property taxes, and that further increases in excise taxes should depend on profitability of companies in the relevant sectors. With respect to pension reform, the authorities stressed the importance of maintaining a fiscally balanced system, and are committed to making additional modifications as needed to achieve this. They did not see room to lower the SSC rate at this time.

C. Monetary and Exchange Rate Policy: Maintaining Stability

21. The authorities have strengthened the monetary and exchange rate policy framework. In 2015, the central bank (NBRB) replaced its crawling peg with a de jure managed floating exchange rate regime and money aggregate targeting. The authorities established broad money as the nominal target, and BYR base money as the operational target. Interventions in the foreign exchange market are broadly rules-based, guided by a wide crawling band allowing smoothing and opportunistic build-up of reserves. The authorities' medium-term objectives are to: (i) reduce inflation to 5 percent by 2020; (ii) rebuild reserves to a 'safe' level of US\$10 billion (roughly 100 percent of the Fund's ARA RAM metric); and (iii) gradually transition to inflation targeting. In July 2016, the authorities redenominated the currency to help boost confidence, issuing new bills ("BYN") that dropped four zeros.³ A staff assessment concluded that Belarus has eliminated all

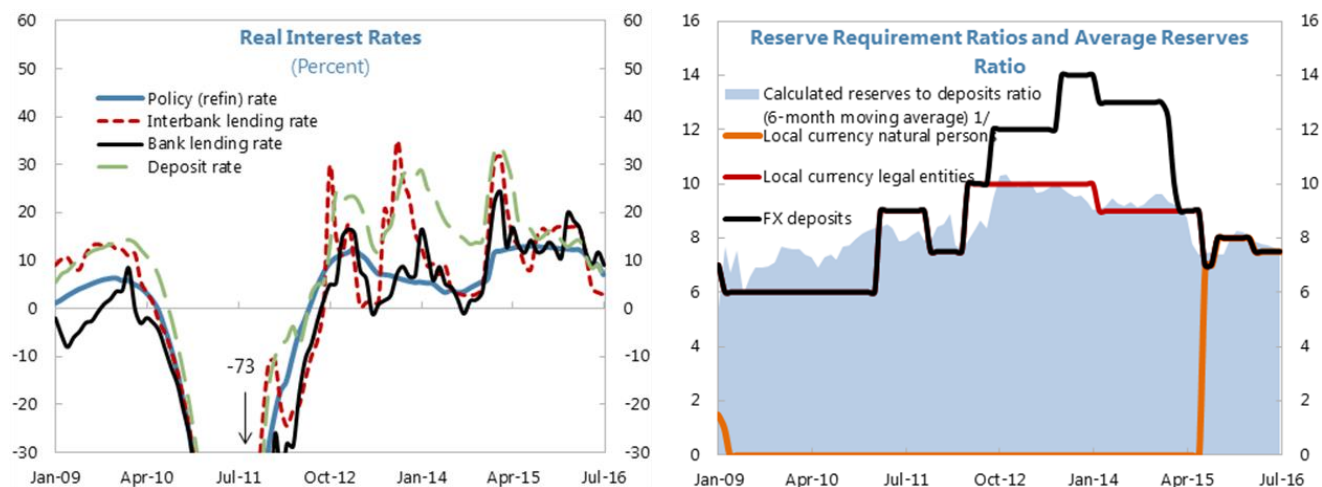
³ Given lags in official sector data reporting, this staff report presents figures in the 'old' currency, "BYR".

(continued)

previously identified multiple currency practices (MCPs) and exchange restrictions subject to IMF jurisdiction under Article VIII.⁴

22. Monetary policy has been tight in 2015–16 (Figure 8; Table 4). Monetary aggregate growth has been contained at levels broadly consistent with the authorities' inflation objective for 2016 of 12 percent (while excess liquidity and credibility gains have allowed some reduction in the interest rate corridor). The reserve requirement has been used as an instrument to address structural liquidity in the banking system as well as the dynamics of money supply. Over the past two years, the NBRB lowered overall reserve requirements and unified the rate on domestic and foreign currency deposits at 7.5 percent.

23. Domestic credit growth remains subdued, despite excess domestic currency liquidity in the system and lower interest rates. This reflects both supply and demand factors: banks remain risk averse given rising NPLs while corporate and HH balance sheets and incomes are weakened and face dim near-term market prospects. These factors, combined with high dollarization and the significant share of government directed lending have contributed to a weak interest rate transmission mechanism. The authorities expect the ongoing reduction in directed lending will help address this, but have also introduced prudential limits on lending and deposit rates to guide the yield curve and help reset market premia more in line with gains in credibility (Annex IV).



Sources: Belarusian authorities; and IMF staff calculations.

1/ Cash in vault, required and excess reserves to deposits included in broad money.

⁴ Belarus eliminated previously identified exchange restrictions arising from the requirement of an NBRB permit for: (i) advance payments for imports and payments for imports with delivery outside of Belarus; and (ii) the multiple currency practices arising from: (a) the potential deviation by more than two percent of the exchange rates in the over-the-counter (OTC) market and the Belarusian Currency and Stock Exchange (BCSE); (b) the potential deviation by more than two percent of the exchange rates in the OTC market and the BCSE exchange rate or the official exchange rate with respect to the mandatory resale of unused foreign exchange by resident legal entities and foreign exchange amounts subject to mandatory sale requirement; and (c) broken cross rates among the currencies for which the NBRB establishes official exchange rates with monthly frequency with respect to the mandatory resale of unused FX by resident legal entities and FX amounts subject to mandatory sale requirement.

Staff Recommendations

24. Staff urged the NBRB to maintain its focus on lowering inflation, while safeguarding external and financial stability. The NBRB's monetary policy stance (aggregate money growth target) for 2016 looks broadly appropriate, though further efforts (including structural reforms and steps to enhance central bank credibility) will be needed to bring medium-term inflation down in line with objectives. With respect to the recently imposed prudential limits on interest rates, the mission urged the NBRB to: (i) undertake an impact assessment of the measures, including their impact on new lending and on depositor behavior; (ii) treat these measures as temporary; and (iii) rely primarily on macroeconomic stabilization and progress in reducing vulnerabilities in the real and financial sector balance sheets to bring down market interest rates. The mission advised the NBRB to stand ready to tighten money aggregates if imbalances and financial sector pressures re-emerge.

25. To further enhance monetary policy effectiveness, staff recommended strengthening NBRB operations and operational independence. Staff urged the authorities to: (i) amend the NBRB statute to clarify the primacy of price stability; (ii) recapitalize the NBRB; (iii) strengthen communications; and (iv) propose a transition timeline to an interest rate-based operational target and then inflation targeting.

26. Staff recommended that the authorities maintain exchange rate flexibility while seeking opportunities to rebuild reserves. The flexible exchange rate remains an important shock absorber, and interventions should remain limited to smoothing volatility and rebuilding reserves to more adequate levels as conditions allow. Given balance-sheet vulnerabilities, the authorities were advised to facilitate real exchange rate adjustment (and promote export competitiveness) through structural reforms.

Authorities' Views

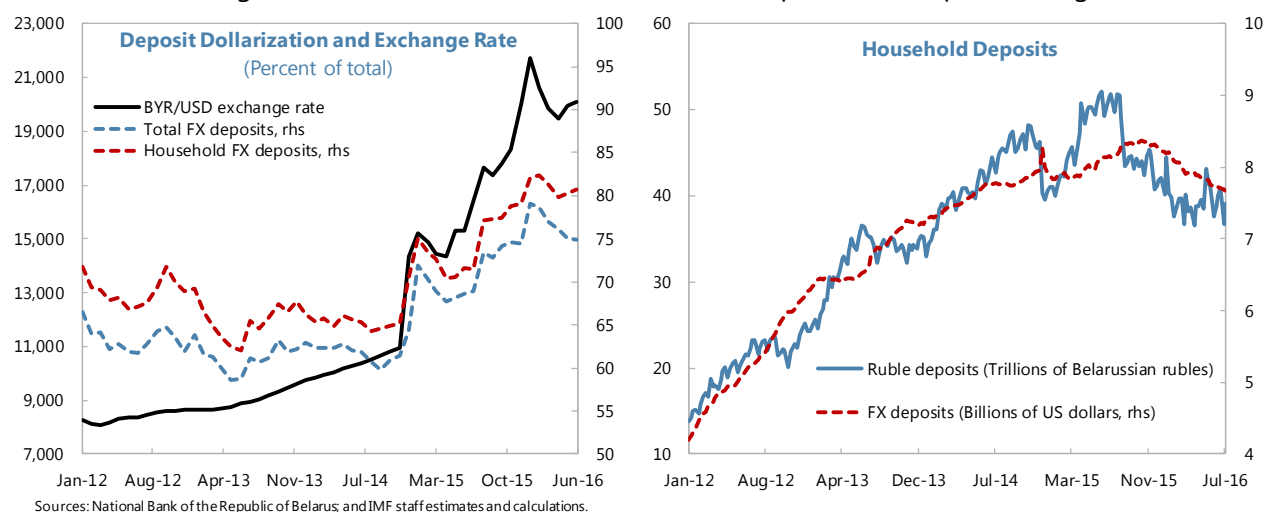
27. The NBRB broadly agreed with staff views on monetary policy. The central bank considers the current tight monetary policy stance as appropriate for reducing inflation. The NBRB noted it has been building credibility through firm implementation of the money aggregate target framework. The authorities view a stronger interest rate transmission mechanism as a prerequisite for adopting the policy rate as the operational target, and for the eventual adoption of an inflation targeting regime. The NBRB noted that its operational independence is sufficiently ensured by the Banking Code, combined with provisions on its independence from other ministries and well-specified issues on which the NBRB reports to the Presidential Administration. In addition, draft amendments to the NBRB statute are being prepared which will clarify price stability as one of the main objectives.

28. The authorities agreed on the importance of maintaining a more flexible exchange rate regime, while aiming to rebuild external buffers. They emphasized that the exchange rate is market-determined with rules-based FX interventions limited to smoothing excessive volatility or to maintain financial stability in the face of sharp exchange rate depreciation. The authorities broadly agreed with staff's assessment of reserve adequacy. They are aiming for a steady buildup of reserves

over the medium term, though some counterparts noted that reliance on further external borrowing to rebuild buffers would carry risks of its own. The authorities felt that the exchange rate had settled to a level broadly consistent with fundamentals or even overshot, noting that the real exchange rate was below its historical average. They saw current account deficits of 2 percent of GDP or below being financeable by FDI inflows, which had historically averaged similar levels. The authorities agreed with the emphasis on structural reforms to deliver external adjustment, noting that high dollarization added to the costs of any further significant depreciation.

D. Financial Sector: Bolstering Stability and Market-Based Lending

29. The financial sector is severely strained. (Figure 9; Table 5). The recent FSAP assessment highlighted concerns about credit and FX liquidity risks, and financial stability frameworks (Box 6). Credit risk is being reflected in increasing NPLs while provisioning rates remain low. Deposit outflow has slowed, but deposits remain well below their 3Q2015 peaks. Banks' net open foreign currency positions are within tight prudential requirements, though FX liquidity coverage ratios are low (reflecting mismatches in short-term assets and liabilities for some currencies). Recently introduced measures to distinguish between revocable and irrevocable deposits are steps in the right direction.



30. The authorities are taking some important steps to reduce financial sector vulnerabilities. In 2015, they closed four small banks, removed 1.5 percent of GDP in bad assets from state-owned bank balance sheets, and established a Financial Stability Department in the NBRB to monitor macro-financial linkages and risks. They also held the first meeting of the recently established the Financial Stability Council and engaged the EBRD to help divest two state-owned banks. In 1H2016, the NBRB initiated Independent Diagnostics Studies ("AQRs") of the top 9 banks.

Staff Recommendations

31. Staff stressed the urgency of implementing further measures to bolster financial stability and strengthen market-based intermediation. Staff urged follow-up on key FSAP recommendations, in particular to:

- **Strengthen bank financial resilience.** There is an urgent need to transition to an independent and risk-based oversight of the financial sector. A well-functioning financial safety net should be put in place. Bank FX liquidity buffers should be enhanced, including through a gradual increase in the FX component of reserve requirements on foreign currency deposits. An enhanced set of macroprudential policies could help contain FX liquidity risk from dollarization. Once the results of the AQR are known (expected in 3Q2016), the authorities should firmly address any needed recapitalization and restructuring of banks.
- **Strengthen the NPL resolution framework.** Staff emphasized that the framework should be comprehensive and well-coordinated with SOE reforms and cuts in directed lending. Designating a single entity for bad asset management, possibly paired with a lead role in SOE restructuring, would better mitigate fiscal risks compared to more piece-meal approaches. Staff recommended that the framework include appropriate valuation of assets and a broad range of instruments—including privatization, P&A, and out-of-court settlements—that allow for permanent solutions.
- **Maintain a limited, well-targeted role for the Development Bank (DB).** Staff recommended that DB operations be limited to areas not adequately addressed by commercial banks, such as longer-term SME lending and export-import financing on terms consistent with international obligations and best practice. The mission suggested that further consideration be given to the mandate of the DB, consulting with international partners, targeting areas of market failure and consistent with priority government policies. It could also include financing of infrastructure investment. Staff urged that the prohibition on retail deposits remain in place. The mission noted that DB operations could also include government-directed lending, so long as it is consistent with overall phase down planned by the government.

Authorities' Views

32. The authorities expressed their commitment to implement the recommendations of the FSAP mission. They agreed with the key areas of importance highlighted in the FSAP report and plan to develop an implementation road map. However, they expressed concern about the recommended approach to improve foreign exchange liquidity buffers, specifically the proposed distinction of reserve requirements for local and foreign currency deposits (with a higher requirement for the latter), given implications for the current setup of monetary policy operations. They noted that the distinction between revocable and irrevocable deposits introduced from April 2016 has contributed to improving banks' funding bases. The authorities plan to continue efforts to de-dollarize the economy. They highlighted recent progress in addressing NPLs, including the imminent launch of an asset management company (AMC) to restructure bad bank assets as a part of overall rehabilitation plan for the agricultural sector. If successful, the authorities indicated the AMC could take on bad assets from other sectors. The authorities see a prominent role for the DB in export financing, SME loans, and infrastructure investment financing, given their assessment of market failures in those areas. They stressed that SME lending by the DB is conducted under a WB-designed program or done with similar principles on market terms, and are important for enhancing

the share of private sector in the economy. The authorities noted that the provision of export financing is in line with OECD rules.

STAFF APPRAISAL

33. The authorities have taken some welcome steps to support stabilization and reduce vulnerabilities, but more is needed. Faster and deeper progress on the reform agenda, particularly in the closely linked SOE and financial sectors, is needed to reduce macro financial vulnerabilities and raise growth prospects. Specific SOE sector measures should include developing and implementing a comprehensive SOE reform strategy that strengthens monitoring and diagnostics, phases out production targets, scales down government directed lending, and strengthens corporate governance. More specific time-bound measures are needed to achieve full utility tariff cost recovery by the end of 2018. Further steps should be taken to strengthen the business environment, including through stronger competition policies and seeking WTO membership.

34. Fiscal policy should be further strengthened and recalibrated. In the near-term, fiscal policies should prioritize well-targeted social safety nets and support for structural reforms (including SOE reform and recognition of contingent liabilities from quasi-fiscal activities). Over 2017-21, fiscal consolidation averaging about 0.5 percentage points of GDP per year is recommended (including through wage restraint) to bring debt down to target levels over the longer term while also providing resources for spending priorities (e.g., capital expenditures). The fiscal framework should be strengthened by: (i) including government guarantees in the debt limit; (ii) adding an explicit fiscal expenditure adjustment rule to achieve debt targets; and (iii) increasing transparency and identification of risks in the budgetary process, including by bringing quasi-fiscal items such as directed lending subsidies on budget.

35. The current monetary policy stance is appropriate. The NBRB's aggregate money growth target for 2016 is consistent with inflation objectives. The recent lowering of the policy rate corridor is consistent with both re-pricing of the risk premium—given credibility gains by the NBRB—and with recent liquidity and inflation developments, amid tight credit to the economy. Prudential measures aimed at lowering lending and deposit interest rates should be temporary, and should not be enhanced in the near term until further assessment is made of the impact of these measures on inflation pressures and the financial sector, including depositor behavior. To further strengthen NBRB credibility and facilitate a transition to inflation targeting, the NBRB's operational capacity and independence should be strengthened. Staff welcomes the elimination of the previously identified multiple currency practices and exchange restrictions.

36. External stability should be reinforced by structural reforms and rebuilding buffers. Maintaining exchange rate flexibility remains important as a shock absorber, with interventions limited to smoothing volatility and rebuilding reserves as conditions allow. Given balance-sheet vulnerabilities, the authorities should promote export competitiveness through structural reforms. Pay down of public FX-denominated domestic bonds is desirable in the medium term to reduce FX

exposure and support de-dollarization, but will need to be gradual in order to protect the fragile reserve position. Gradually strengthening bank reserve requirements on FX deposits is appropriate for building better bank FX buffers.

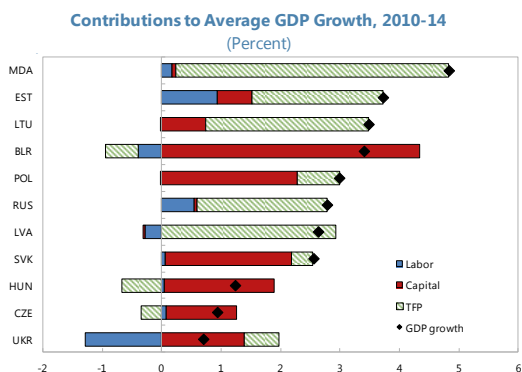
37. To strengthen financial stability and facilitate more market-based intermediation, the main findings of the FSAP should be implemented. It is critical to transition to an independent and risk-based oversight of the financial sector. Other important areas include: (i) strengthening bank financial resilience, including by completing AQRs and increasing FX liquidity buffers; (ii) designing a holistic and in-depth NPL resolution strategy alongside corporate restructuring and phasing out directed lending; (iii) designing a well-functioning financial safety net; (iv) strengthening macro prudential policies to contain FX liquidity risks from dollarization; and (v) maintaining a limited, well-targeted role for the Development Bank, with operations primarily focused on areas not adequately addressed by commercial banks.

38. It is proposed that the next Article IV consultation be held on the standard 12-month cycle.

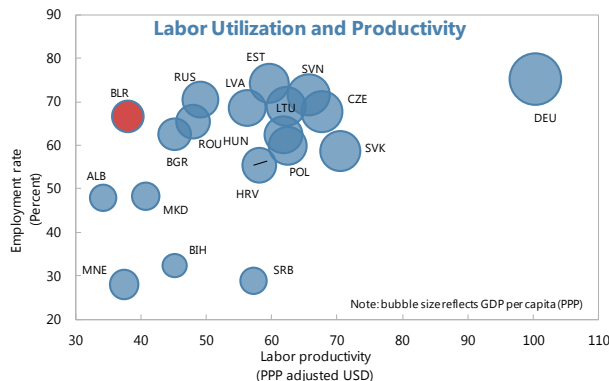
Box 1. Belarus: From Extensive to Intensive Growth

Past real GDP growth has been based on factor accumulation, with very high investment.

Between 1995 and 2008, growth was rapid, driven by very high investment. However, high growth was not sustainable or effective—neither from a macro-perspective (it led to high current account deficits), nor from a micro-perspective (the sharp expansion of the capital stock was increasingly offset by falling efficiency levels). *A change towards more intensive growth is needed with a much larger role for efficiency increases.* More reliance on market mechanisms would help in this, and would address both macro and micro problems.



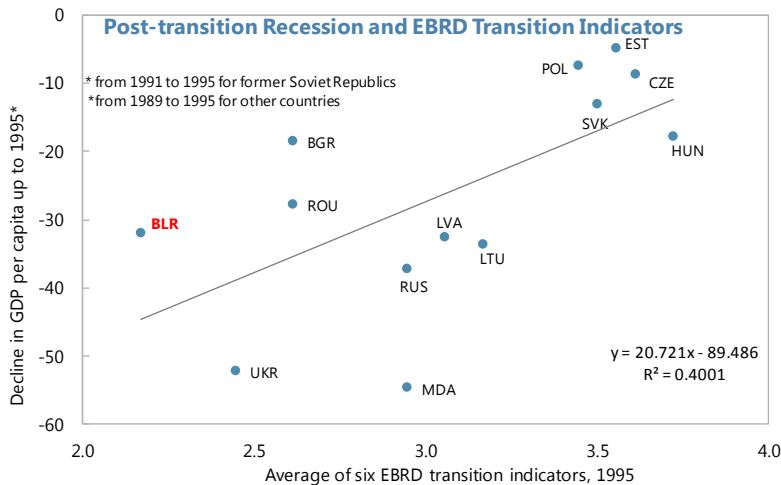
Source: Total Economy Database, and IMF staff calculations.



Source: Eurostat, WEO database, and IMF staff calculations.

Lessons from early transition suggest that waiting with reforms may not lessen the pain. In

the early 1990s, economists debated whether transition to a greater market orientation should be gradual or rapid. The main concern about more rapid reforms was that it would lead to high unemployment. Some countries (Czech Republic, Poland, Baltic countries) opted for rapid reforms, while others (CIS countries, Bulgaria, Romania) reformed more gradually. In the event, rapid liberalizers had shallower recessions and stronger long-term growth. Slower liberalization did not moderate the pain—it exacerbated it.



Source: Penn World Tables, EBRD, and IMF staff calculations.

Box 2. Belarus: External Stability Assessment

Belarus's external position is fragile in the wake of external shocks and deep recession.

Gross international reserves (GIR) (\$4.3 billion at end-June 2016) are equivalent to about (30) 40 percent of the ARA metric for (fixed) floating exchange-rate countries—well below most adequacy thresholds and below predetermined short-term net FX drains (\$5.9 billion). The authorities see GIR of around \$10 billion (100 percent of ARA metric for floating exchange rates) as adequate. The level of reserves stabilized following the central bank's shift to a more flexible exchange rate regime.

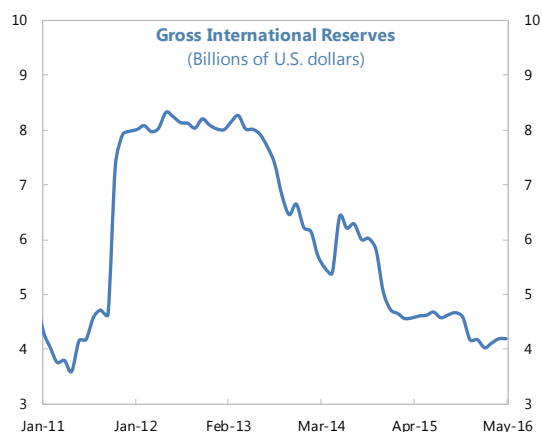
The net international investment position (NIIP) reached -82 percent of GDP at end-March 2016. NIIP remained unchanged in dollar terms during 2015, but deteriorated by 20 percentage points of GDP owing to exchange rate depreciation and recession.

The current account deficit (CAD), historically volatile, has narrowed from 10 percent of GDP in 2013 to 3.8 percent in 2015. Import compression has offset weak exports and the negative impact from low oil prices—which contribute to negative spillovers from Russia and erode comparative benefits from energy imports from Russia that are priced below world price levels.

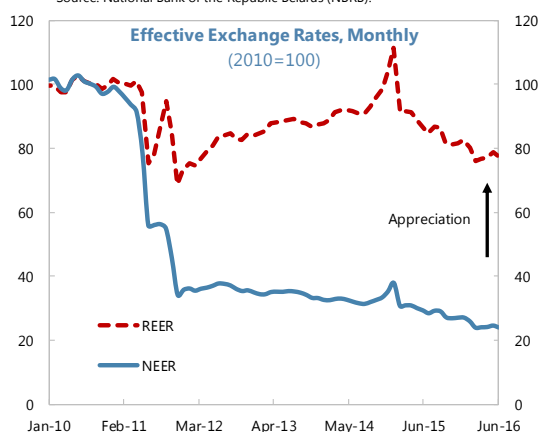
EBA-Lite methodologies indicate a real overvaluation of up to 10 percent, still significant but below previously reported estimates. The two approaches for Belarus show the CAD remaining above estimated norms:

External sustainability approach. Under baseline growth prospects, a current account (CA) norm of -0.2 percent of GDP would be needed to stabilize the NIIP at -60 percent of GDP by 2035. This compares with an underlying CA of -3¼ percent of GDP (baseline projection). Applying CGER elasticities to the resulting CA gap of 3.1 percent of GDP implies a REER gap of 8 percent.

CA approach. This approach estimates a CA norm of -0.1 percent of GDP (versus 2015 CA of -3.8 percent of GDP) based on a regression-based "fitted" value (-0.3 percent) and a policy gap (-0.2 percent) derived by: (a) making room for an annual increase in reserves of about \$1 billion; and (b) setting other policy variables to their actual 2015 values. Under the resulting CA gap of 3.7 percentage points of GDP, CGER elasticities imply a REER gap of 10 percent.



Source: National Bank of the Republic of Belarus (NBRB).



Source: IMF Information Notice System.

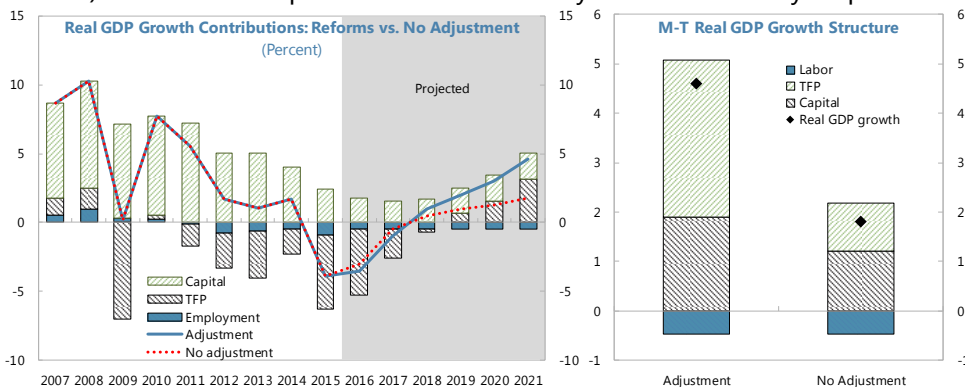
Box 3. Belarus: Baseline and Adjustment Scenarios, 2016–21

In 2016, the Belarusian economy is projected to contract by 3 (3½) percent under staff’s baseline (adjustment) scenario, as domestic demand falls. (Figures 10 and 11). Inflation is expected to rise, reflecting depreciation and seasonal factors.

Under staff’s baseline scenario, medium-term growth will remain tepid, with rising vulnerabilities. Output will bottom out next year. Reforms being undertaken by the authorities support a small upward revision of medium-term potential growth, to around 1¾, compared to the 2015 Article IV estimate. Inflation will remain in double digits through 2018 as remaining administrative regulation of the economy and energy cross-subsidies continue to distort prices. Constraining factors include limited financing, weak terms of trade, negative demographics, structural impediments, weak bank and corporate balance sheets, uncertainty surrounding high macroeconomic vulnerabilities, muted growth prospects in key trading partners, and insufficient resources to repeat investment-led domestic demand increases of past years. The public sector will continue to rely on placement of FX-denominated paper with banks.

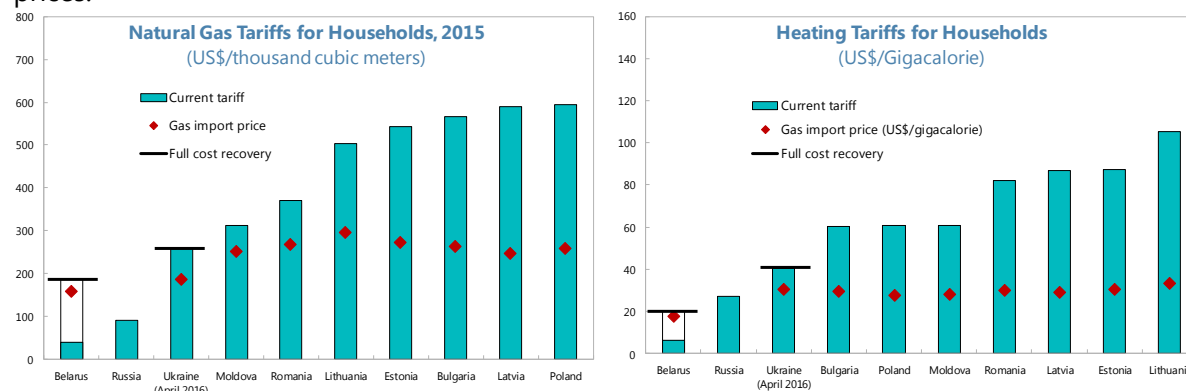
Under the adjustment scenario, real GDP growth will initially be weaker than under the baseline scenario, but will then rebound to relatively higher levels. During 2016–17, consumption and investment will be weaker as directed lending slows and real wages fall (though cushioned by enhanced SSNs). This will be partially mitigated by an improving trade balance—from import compression and some REER depreciation. Inflation is expected to remain in double digits in 2016–17 due to utility tariffs hikes, price liberalization, and further depreciation. Over the medium-term, growth is expected to rise to slightly above 4½ percent, before settling into a longer term potential growth rate of around 3½ percent. Macroeconomic adjustment, positive effects of structural reforms—including SOE and bank reforms to increase market orientation and more market-based pricing—, and stronger corporate and bank balance sheets will create conditions for increased competitiveness and sustainable higher growth. Total factor productivity will rise, accompanied by more efficient resource allocation, higher quality investment, and increased labor participation (from pension and other reforms). Competition policies, easier access to credit, and private enterprise expansion in sectors such as agriculture, utilities, banking, transportation, and healthcare—which have been traditionally dominated by the state—would further support private sector development. Modernization, FDI, and trade liberalization (including WTO accession) would allow export diversification away from commodity-dependent goods and markets.

Inflation will fall to about 6 percent, sustained by market-based price setting and appropriate monetary policy.



Box 4. Belarus: Utility Tariffs and Cost Recovery

Household (HH) utility tariffs in Belarus remain below full cost-recovery levels and lower than in regional peers. Below-cost pricing for HH utility services weighs on public and external balances, encourages overconsumption and underinvestment in efficiency-enhancing measures, and undermines competitiveness of industries that cross-subsidize HHs by paying above cost prices.



HH utility subsidies and fiscal costs in Belarus are significant. Utility subsidies to HHs accounted for around two percent of GDP in 2015, with about 1 percent of GDP financing from the budget and the rest financed by cross-subsidies from industry.

	2015	end 2018
Heating	32	100
Natural Gas	38	100
Electricity	75	100
Sewer	33	100
Water	36	100
Use of elevator	37	100
Technical maintenance	87	100
Removal of waste	83	100
Average (all utilities)	48.5	100

Sources: Belarusian and Ukrainian authorities; and IMF staff calculations.

Belarus's proposed HH utility reforms are comprehensive. The authorities have committed to increase the average cost recovery of all utilities from 48.5 percent in 2015 to 100 percent in 2018. So far in 2016, they have reached 58 percent, and plan to achieve 75 percent cost recovery in 2017.

The authorities are reinforcing SSNs to protect the most vulnerable HHs from the impact of utility sector reforms. While the impact of utility reforms on HH expenditures will be significant, the impact on the poorest is expected to be fully offset by a new targeted social assistance mechanism, effective 4Q2016. The new mechanism will be funded from the budget (with fiscal space generated by lower budget subsidies to utilities).

Box 5. Belarus: Pension System Sustainability and Reform Options

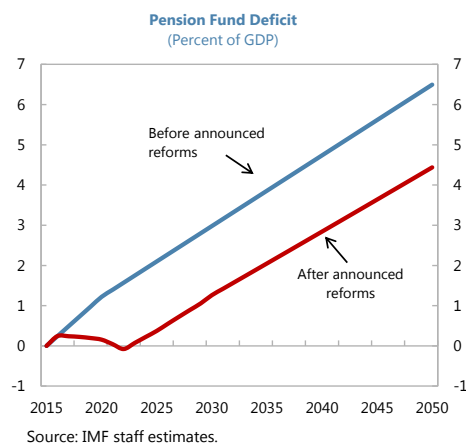
Belarus’s pension system is currently near balance, following policy measures in recent years. Contributions from employers and workers roughly match payments to retirees. This achievement is unusual in the region (many peers have imbalances), and reflects a series of policy measures in recent years to maintain the balance despite negative demographics. These include recent increases in the minimum eligibility period for a retirement pension from 5 to 20 years.

The recent decision to gradually increase the retirement age will offset negative demographics and maintain pension system balance through 2022.

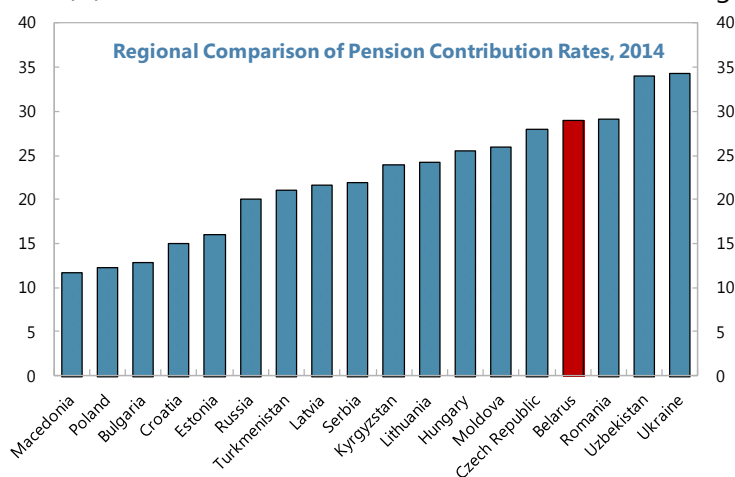
Beginning January 2017, the retirement age will be increased by six months each year, up to 63 years for men and 58 years for women, with equivalent increases for preferential, long-service, and military pensions.

However, further reforms will be needed by 2023 to head off pension system deficits.

Staff analysis projects that the pension system will experience an annual fiscal deterioration of about 0.15 percent of GDP beginning 2023. The authorities have publicly pledged to take additional (but unspecified) measures as needed to maintain pension balance.



Further reforms before 2023 would create space to reduce the very high social security contribution rate of 35 percent (29 percent for pension contributions; 6 percent for other social programs). Measures could include: (i) gradual increases in male and female retirement ages to 65 and then link them to life expectancy; (ii) re-indexing benefits to inflation instead of wage growth in the long-run (though retaining some mix for minimum pensions); (iii) continuing early retirement reduction; and (iv) measures to incentivize labor demand for older age cohorts.



Box 6. Belarus: FSAP Key Findings and Recommendations

Systemic Solvency and Liquidity. Banking sector credit risk is very high, while FX liquidity risk is rising. Credit concentration risk is large at individual banks and indirect credit risk from unhedged borrowers in FX remains a concern. The main risk for systemic liquidity derives from high dollarization of deposits; liquidity stress tests reveal significant pockets of vulnerability in FX positions. Legal, liquidity, and operational risks exist in the interbank payment system. Direct cross-border contagion risks are large, especially from Russia. The insurance sector is exposed to significant contagion risk, through investments in bank deposits and credit default insurance products.

Banking and Insurance Oversight. State ownership increases the complexity of achieving independent risk-based financial oversight. The adjustment of prudential standards as a form of forbearance in the banking sector is eroding market discipline. The lack of detailed requirements on corporate restructuring may result in understated problem loans and evergreening. The NBRB should undertake AQRs on banks with significant differences between their IFRS and local accounting standard provisions and impose Pillar 2 capital add-ons and other forward looking measures to reinforce capital prudential measures. Bank and insurance oversight is constrained by lack of operational independence. The risk management framework for financial market infrastructures needs a stronger legal basis, risk scenarios, and links with central bank governance. The planned move of the supervision of the Development Bank (DB) to the NBRB should be combined with adequate staffing capacity.

Systemic liquidity management. High deposit dollarization and limited access to FX liquidity poses significant risk. The liquidity needs, especially in FX, are likely underestimated as term deposits are callable without penalty. The NBRB should increase the reserve requirement rate for FX deposits required to be integrated in FX accounts, rather than in local currency, and recalibrate mandatory liquidity indicators by currency to better reflect these risks.

Macroprudential policy and framework. The authorities should implement the planned creation of the Financial Stability Council legally mandated for ensuring financial stability. The risk assessment framework should be enhanced, including identification of unhedged FX debtors, and specific measures, such as increasing the risk weights on exposures to unhedged debtors, should be considered to complement macroeconomic policies for de-dollarization.

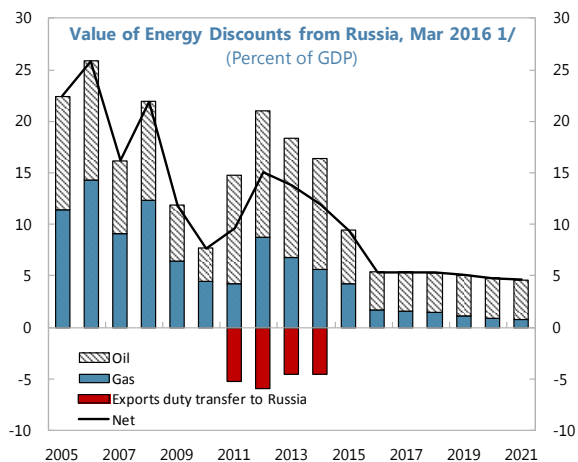
Resolution of NPLs. A holistic and in-depth NPL resolution, hand-in-hand with corporate restructuring, is critical for preserving financial stability. NPL resolution responsibilities should be delegated to an entity with wider powers for debt and enterprise restructuring and with a broad menu of instruments. The legal framework governing creditor/debtor relationships is comprehensive, but several laws and institutions need improvement. Non-judicial and in-court procedures allow quite rapid recovery of NPLs but liquidation and rehabilitation proceedings are perceived as ineffective.

Financial Safety Net. A comprehensive financial safety net is needed. The NBRB should be designated as responsible for bank resolution. Resolution tools should be broadened. A new Emergency Liquidity Assistance facility to provide collateralized emergency liquidity support to solvent banks is urgently needed. The Deposit Insurance Agency should be able to provide funding for purchase and assumption transactions. The authorities should consider limiting the amount of deposit insurance coverage and shortening the payout period, in line with international standards, over time.

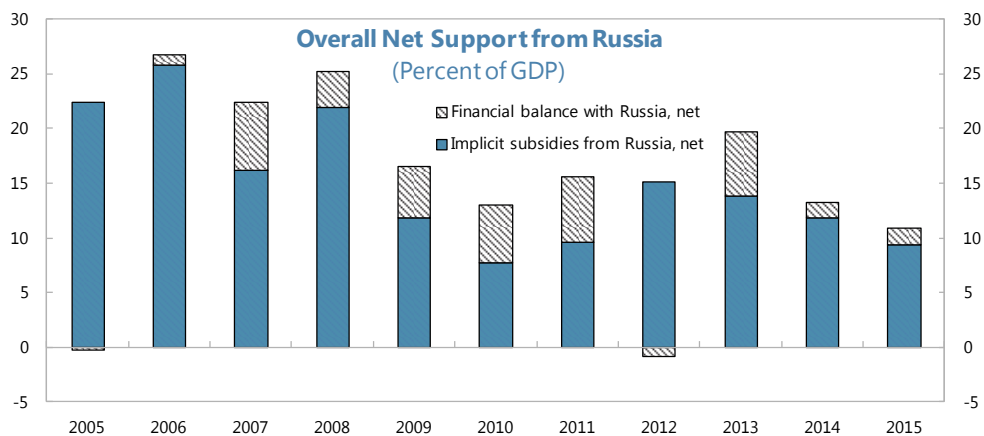
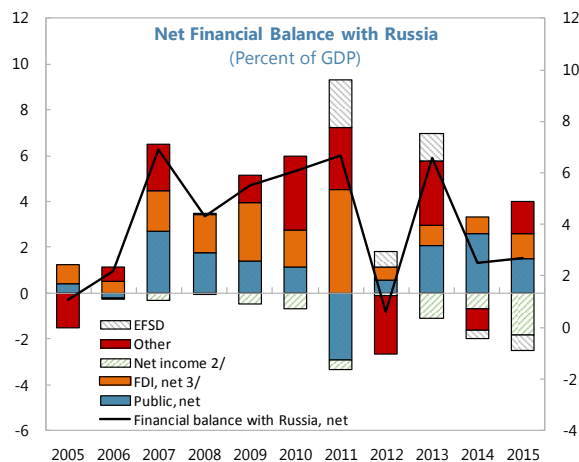
Development Bank. Given the DB's growing role in development finance, its mandate needs to be clarified and its governance, risk management and supervision strengthened. Its focus should be limited to areas not adequately served by commercial banks (e.g., export and SME financing). The DB should continue to be prohibited from taking customer deposits and provide enterprise financing through whole sale lending to other banks. The DB could finance viable infrastructure and longer term investment projects on the basis of competitive project selection and cost-benefit analysis.

Figure 1. Belarus: Economic and Financial Linkages with Russia and ROW, 2005–21

Russia has provided support through energy pricing ...

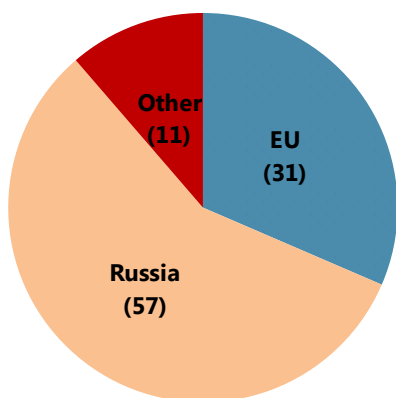


... and financial support, directly and through a regional fund.



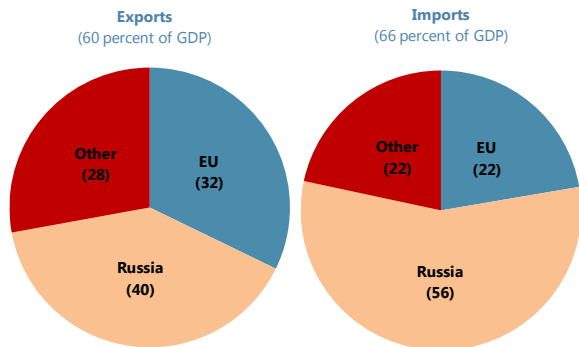
Russia is Belarus's largest foreign investor ...

FDI Stock, (23 percent of GDP in 2014)
(Percent of total)



...and largest trading partner.

Trade Flows in Goods
(Percent of total, 2012-15 average)



Sources: Coordinated Direct Investment Survey; Direction of Trade Statistics; Belarusian authorities; and IMF staff calculations.

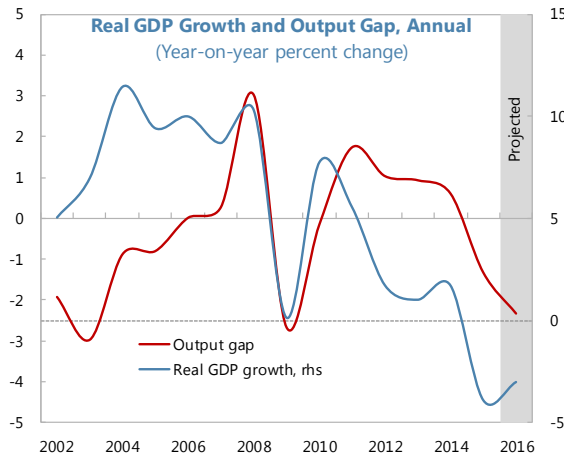
1/ Reflects spread between world energy price and price paid by Belarus to Russia.

2/ Beginning 2013, includes cross-border dividends.

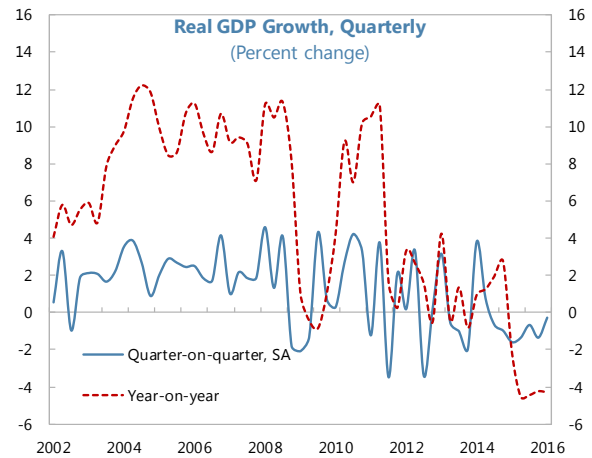
3/ Includes Cyprus.

Figure 2. Belarus: Real Sector Developments, 2002–16

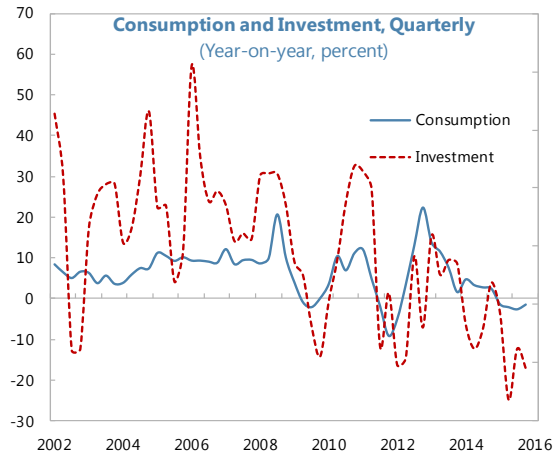
The economy continues to contract.



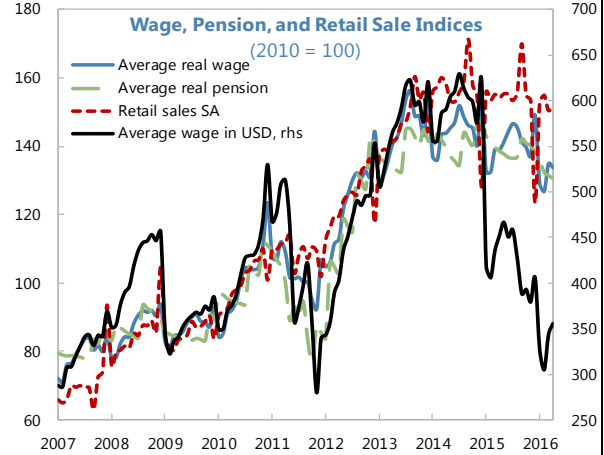
High frequency data point to continuous volatility.



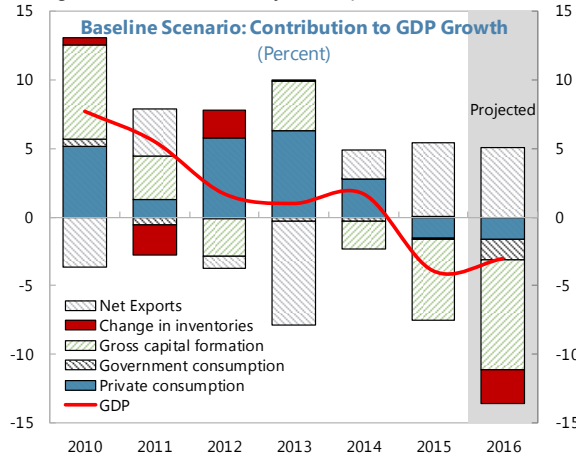
Investment has suffered, with consumption also contracting...



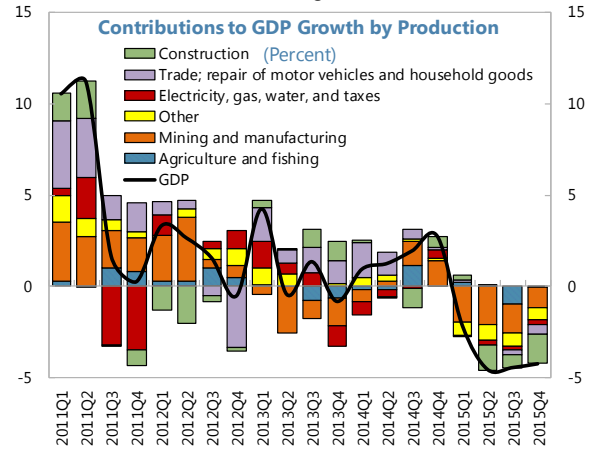
...as real wages have stagnated.



Expenditure-side real GDP results reflect these trends (though off-set somewhat by net exports).



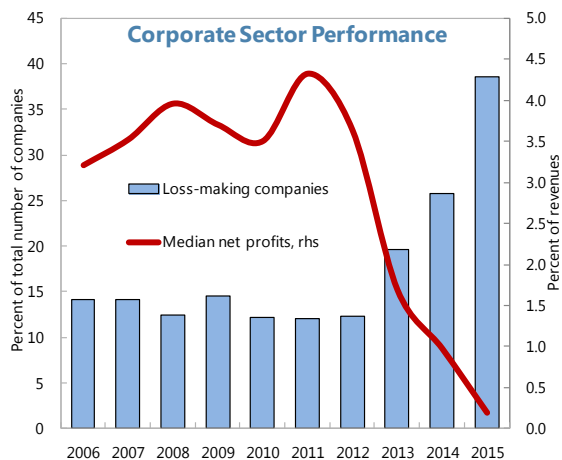
Production-side GDP results show a sharp drop in construction and manufacturing.



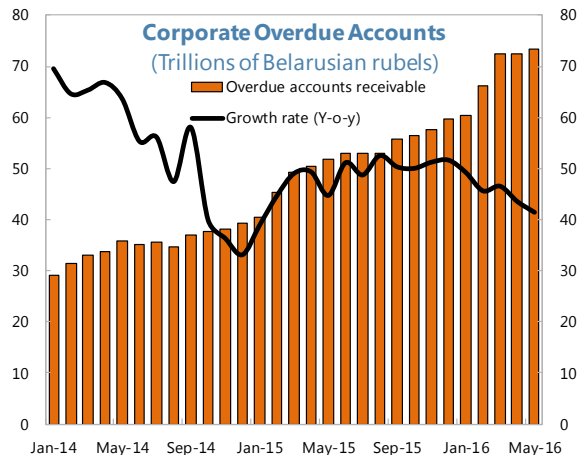
Sources: National Statistical Committee; IMF staff estimates and calculations.

Figure 3. Belarus: Corporate Sector Developments, 2006–16

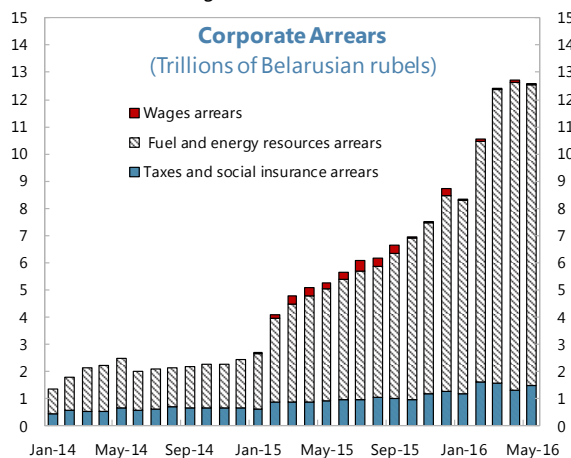
Economic contraction is taking its toll on profitability.



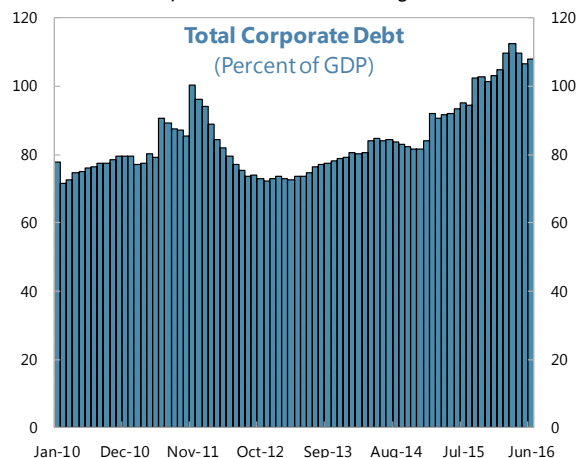
Corporate sector overdue accounts are rising...



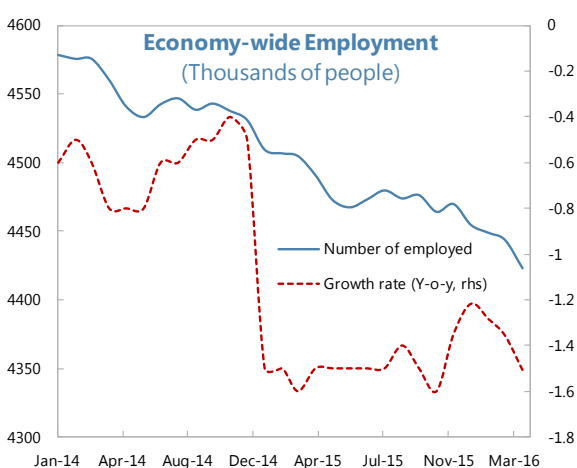
...arrears are building...



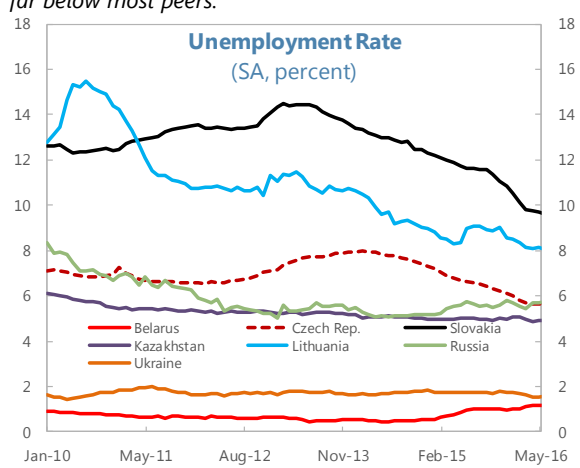
...and overall corporate debt is increasing.



Employment continues to decline...



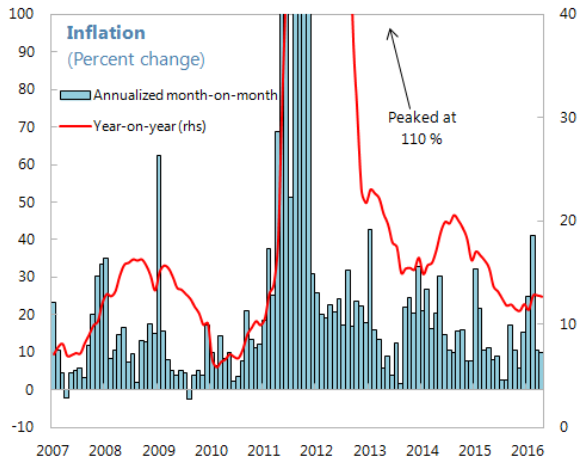
...though official unemployment figures remain low, and far below most peers.



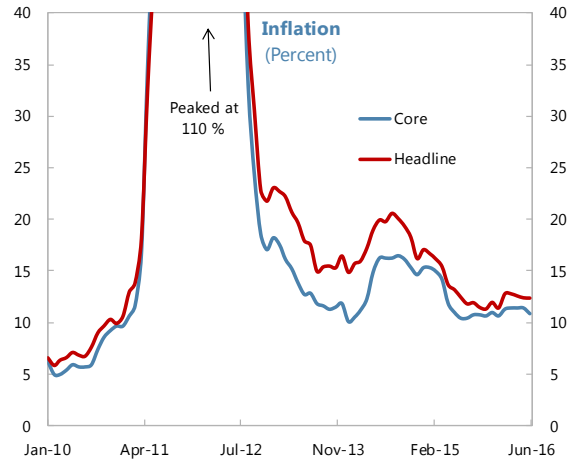
Sources: Belarusian authorities; Haver Analytics; and IMF staff calculations.

Figure 4. Belarus: Inflation Developments, 2007–16

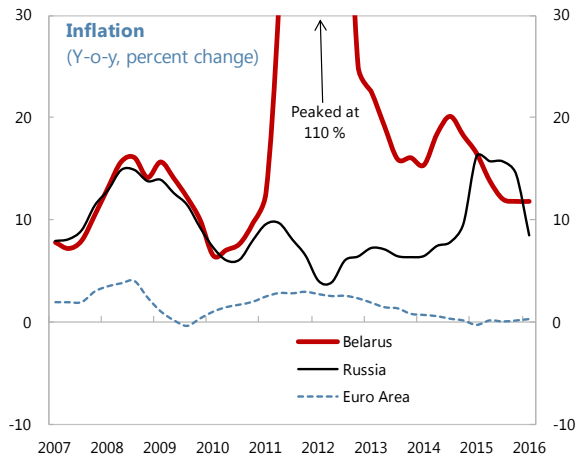
Inflation has declined sharply in recent years....



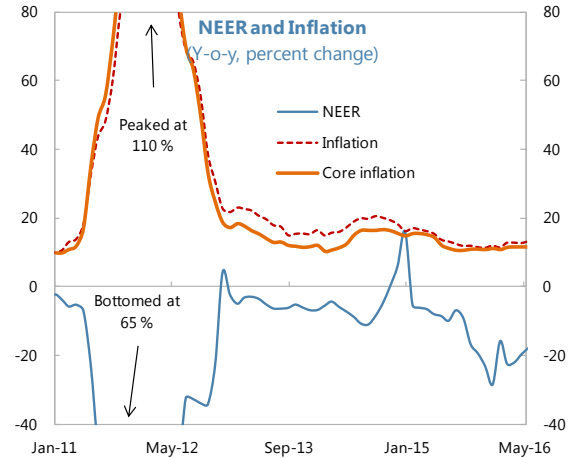
.... but is still at elevated levels.



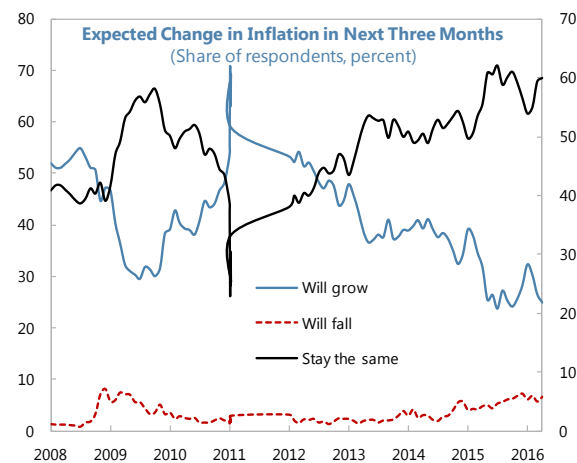
Key trading partners are providing disinflationary pressure.



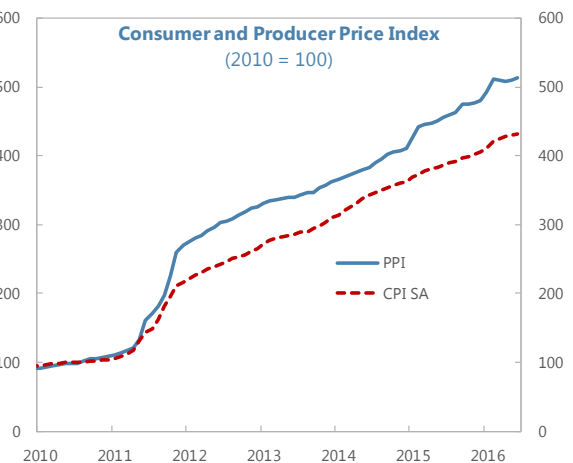
The exchange rate (and pass-through) is stabilizing.



Inflation expectations are adjusting down.



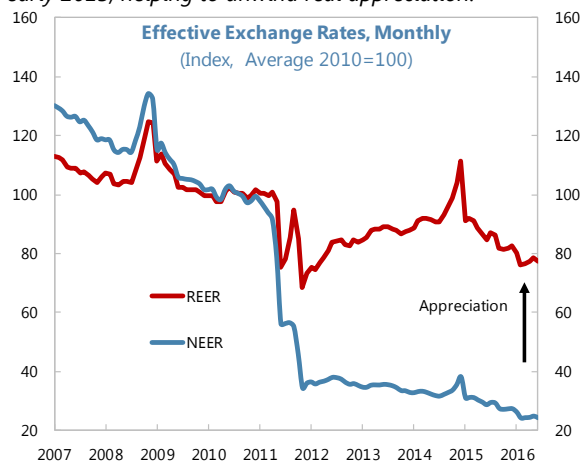
CPI inflation has followed PPI but remained below it.



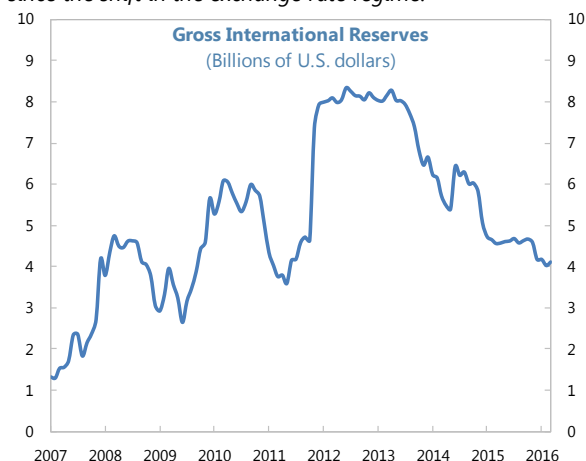
Sources: National Statistical Committee; IMF staff estimates and calculations.

Figure 5. Belarus: External Sector, 2000–16 1/

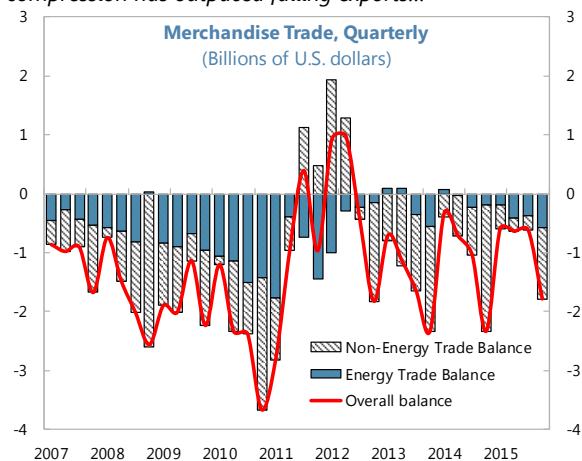
The nominal exchange rate has been more flexible since early 2015, helping to unwind real appreciation.



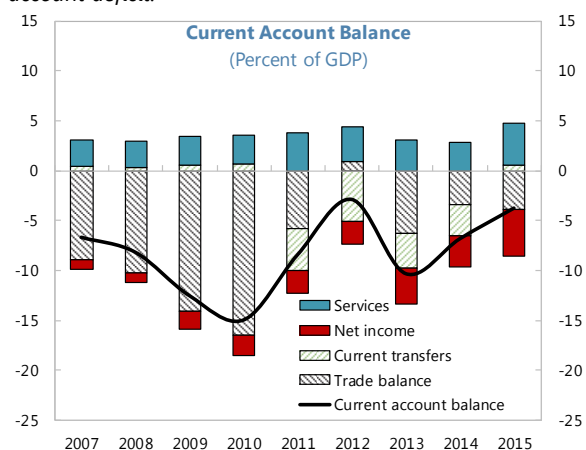
The pace of decline in international reserves has slowed since the shift in the exchange rate regime.



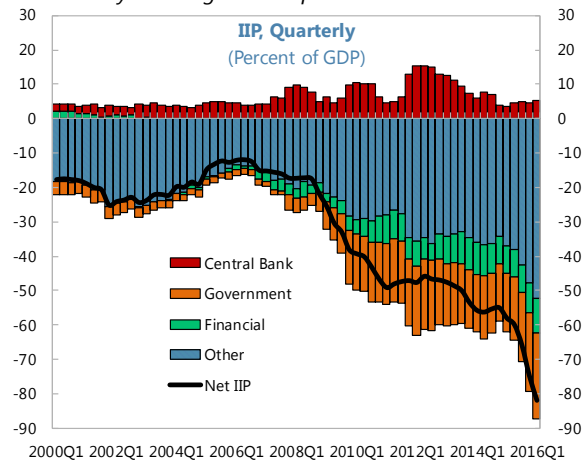
The trade deficit has narrowed since 2013, as import compression has outpaced falling exports...



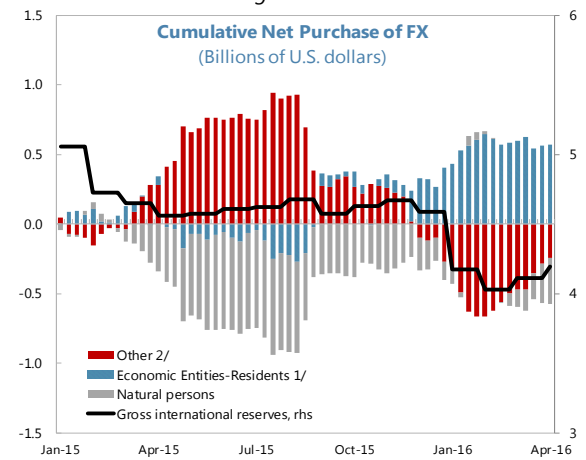
... helping to narrow the historically volatile current account deficit.



The net IIP has deteriorated over the past decade, recently worsened by exchange rate depreciation and recession.



Corporates have increased their FX purchases, while banks and HHs have been selling



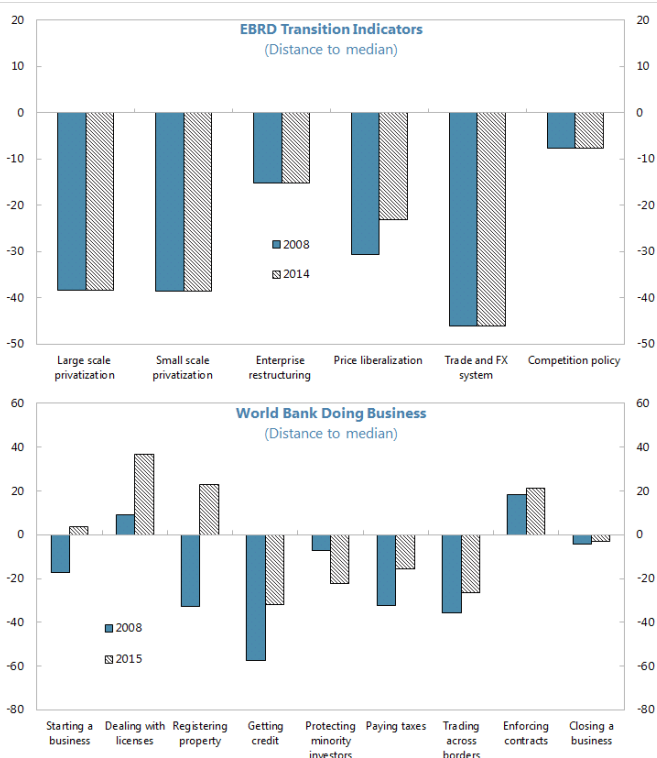
Sources: Belstat; National Bank of the Republic of Belarus; Ministry of Finance of the Republic of Belarus; and IMF staff estimates and calculations.

1/ Economic entities - commercial and non-profit organizations, independent entrepreneurs.

2/ Other - represents the residual counterparty activities to clear the market.

Figure 6. Belarus: Structural Developments, 2008–15

Selected cross-country indicators show improvement in Belarus's business climate, but only limited change in transition indicators.



Belarus: Rankings of Selected Competitiveness and Structural Indicators 1/

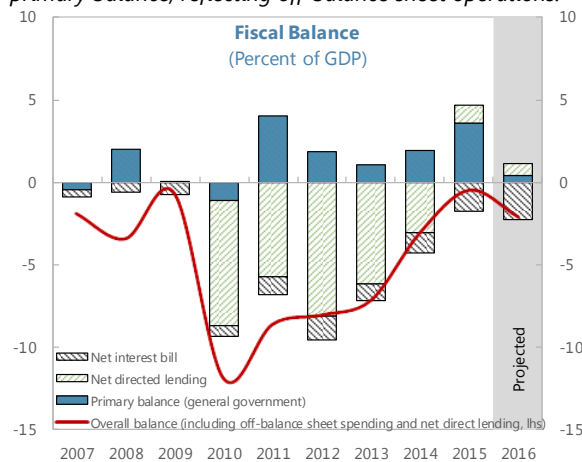
	Belarus	
	2008	2014
EBRD transition indicators	49	50
Large scale privatization	39	39
Small scale privatization	54	54
Enterprise restructuring	39	39
Price liberalization	62	69
Trade and FX system	54	54
Competition policy	46	46
World Bank Doing Business survey	2008	2015
Overall rank		69
Starting a business	47	78
Dealing with licenses	27	72
Registering property	29	98
Getting credit	9	43
Protecting minority investors	40	49
Paying taxes	0	69
Trading across borders	14	24
Enforcing contracts	96	96
Closing a business	55	64

Sources: EBRD; World Bank; World Economic Forum; and IMF staff calculations.

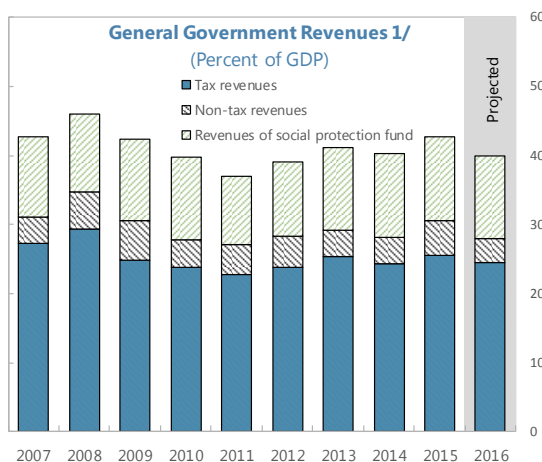
1/ For comparability, all indices normalized so that they range from 0 (lowest) to 100 (best). Comparator countries: Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, FYR, Georgia, Hungary, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Moldova, Mongolia, Montenegro, Poland, Romania, Russian federation, Serbia, Slovak Republic, Slovenia, Tajikistan, Ukraine, Uzbekistan. 2/ Distance of Belarus from best performer (or median performer) for each index.

Figure 7. Belarus: Fiscal Developments, 2000–16

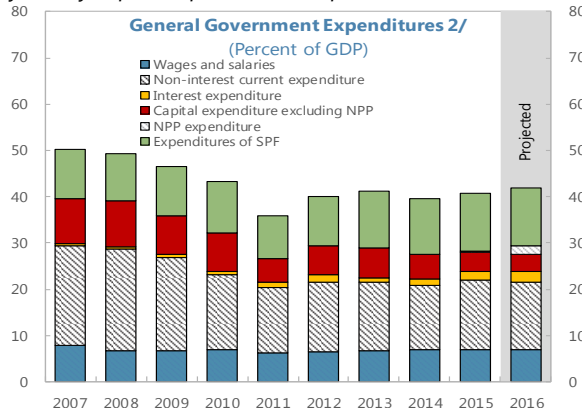
The overall balance has been negative, despite a positive primary balance, reflecting off-balance sheet operations.



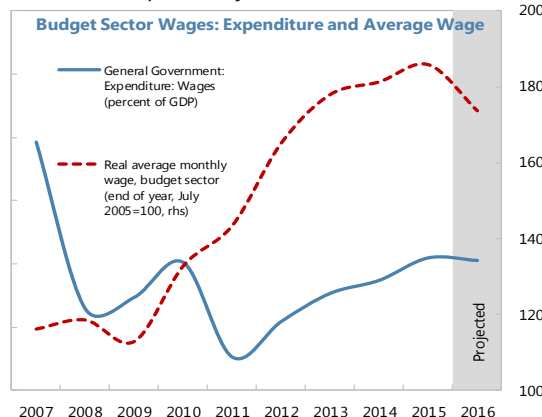
Revenues have been relatively stable...



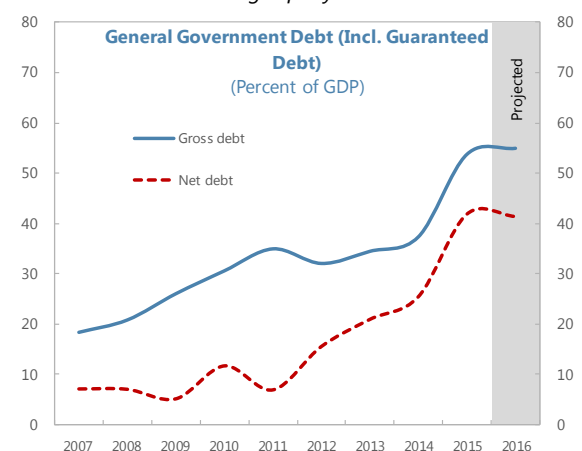
...while expenditures have declined steadily, led in recent years by capital expenditure compression.



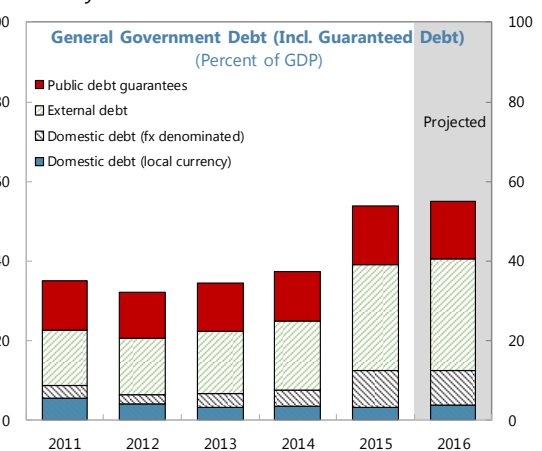
Public wages and the wage bill are now declining, after rapid increases in previous years.



Government debt is rising rapidly...



...particularly FX-denominated debt.



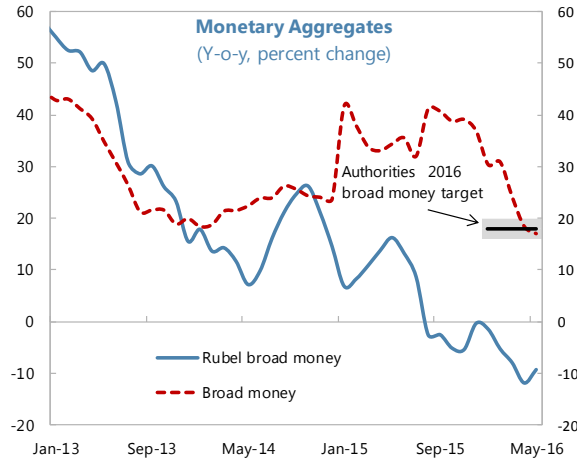
Sources: Belarusian authorities; and IMF staff estimates and calculations.

1/ The sum of revenues is larger than total general government revenues, as part of SPF revenues are from the budget, which is not included in total general government revenues.

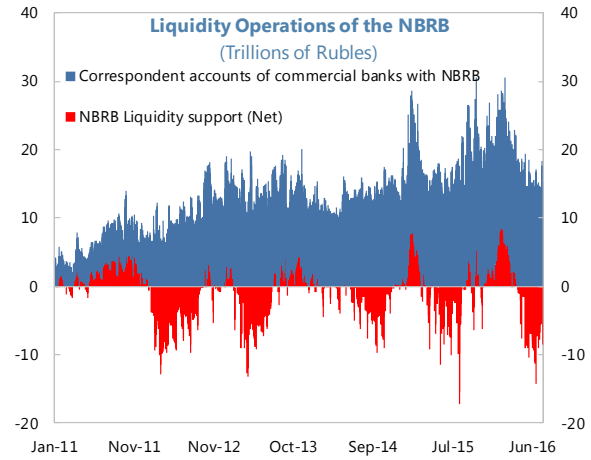
2/ The sum of expenditures is larger than total general government expenditure, as part of government expenditures are paid to SPF, which is not included in total general government expenditures.

Figure 8. Belarus: Monetary Developments, 2011–16

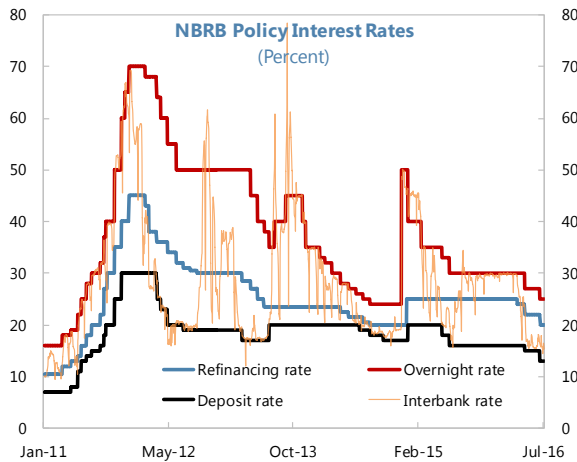
Growth of monetary aggregates is being contained in line with the NBRB's 2016 target.



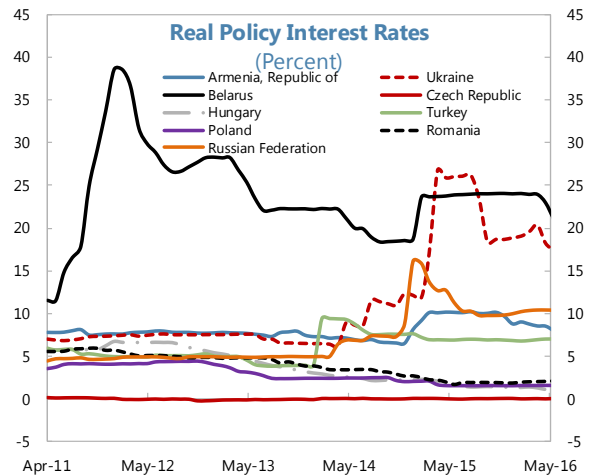
There is excess domestic currency liquidity in the system.



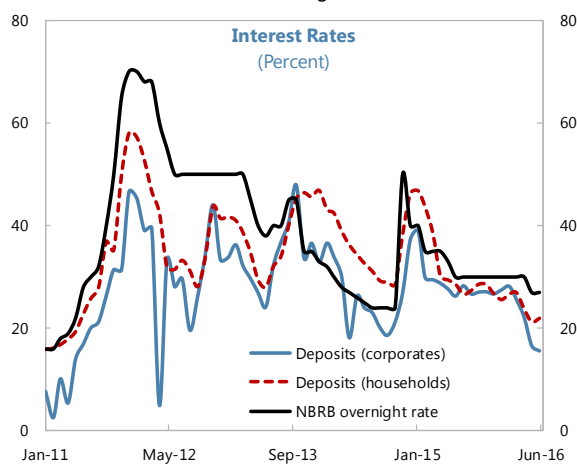
With increased liquidity and decreased volatility, rates for standing facilities are being reduced and the interest rate corridor narrowed.



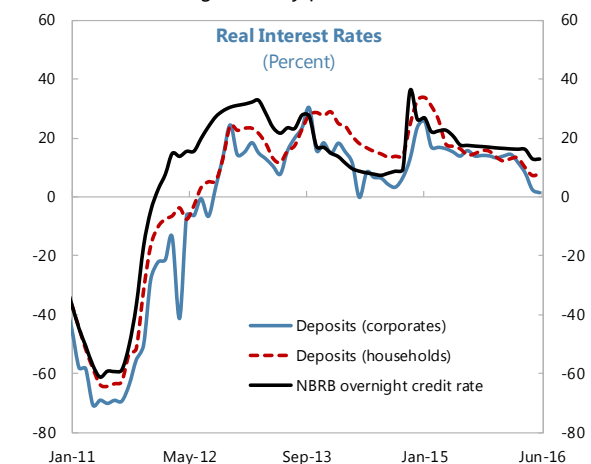
...but real rates remain well-above those in the region.



Market interest rates are tracking down...



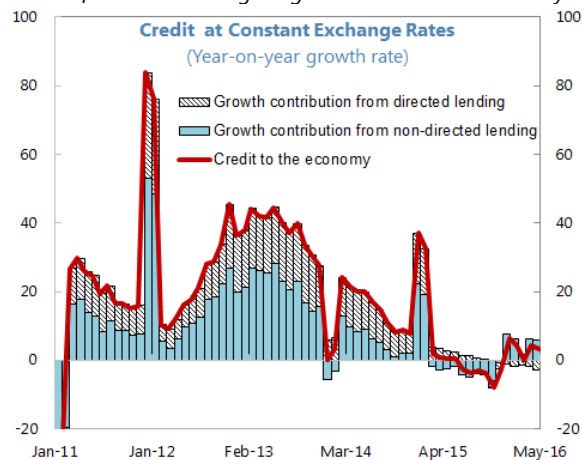
...but also remain significantly positive in real terms.



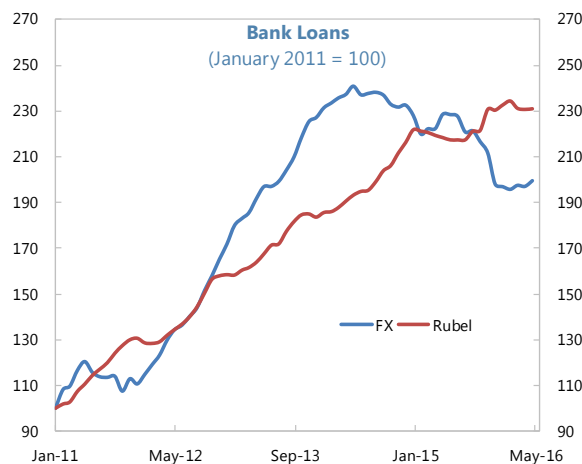
Sources: National Bank of the Republic of Belarus; and IMF staff estimates and calculations.

Figure 9. Belarus: Financial Sector Developments, 2011–16

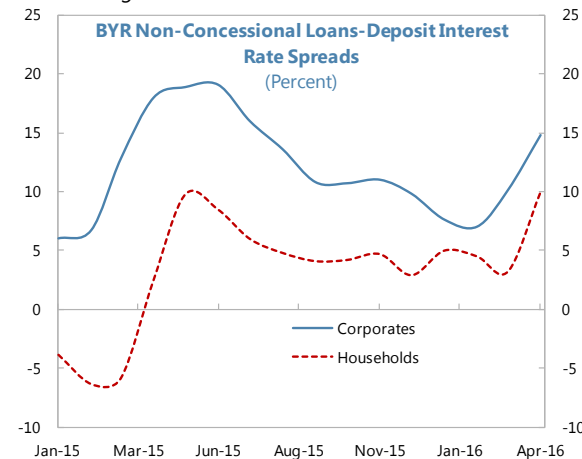
Recession, balance sheet constraints, and gradual scaling down of directed lending weigh on credit to the economy.



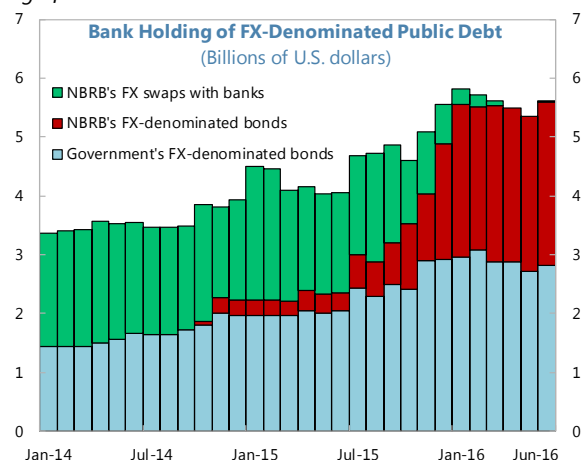
Loans in FX are slowing faster than those in BYR.



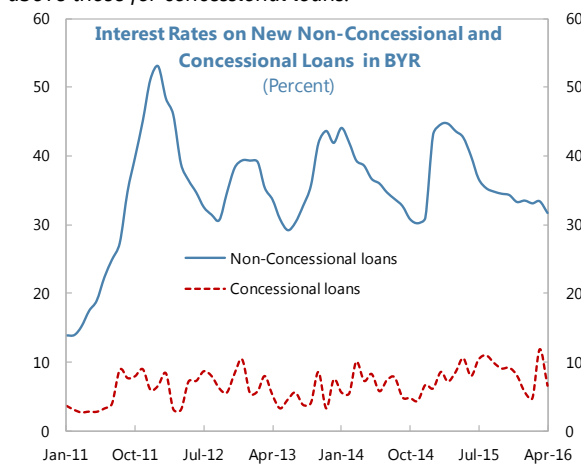
Spreads are widening as deposit rates are falling faster than lending rates.



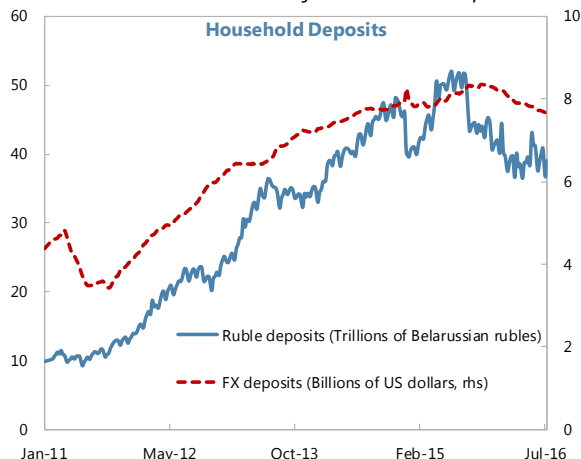
Bank holdings of FX-denominated public sector bonds are significant.



Interest rates on non-concessional loans remain well-above those for concessional loans.

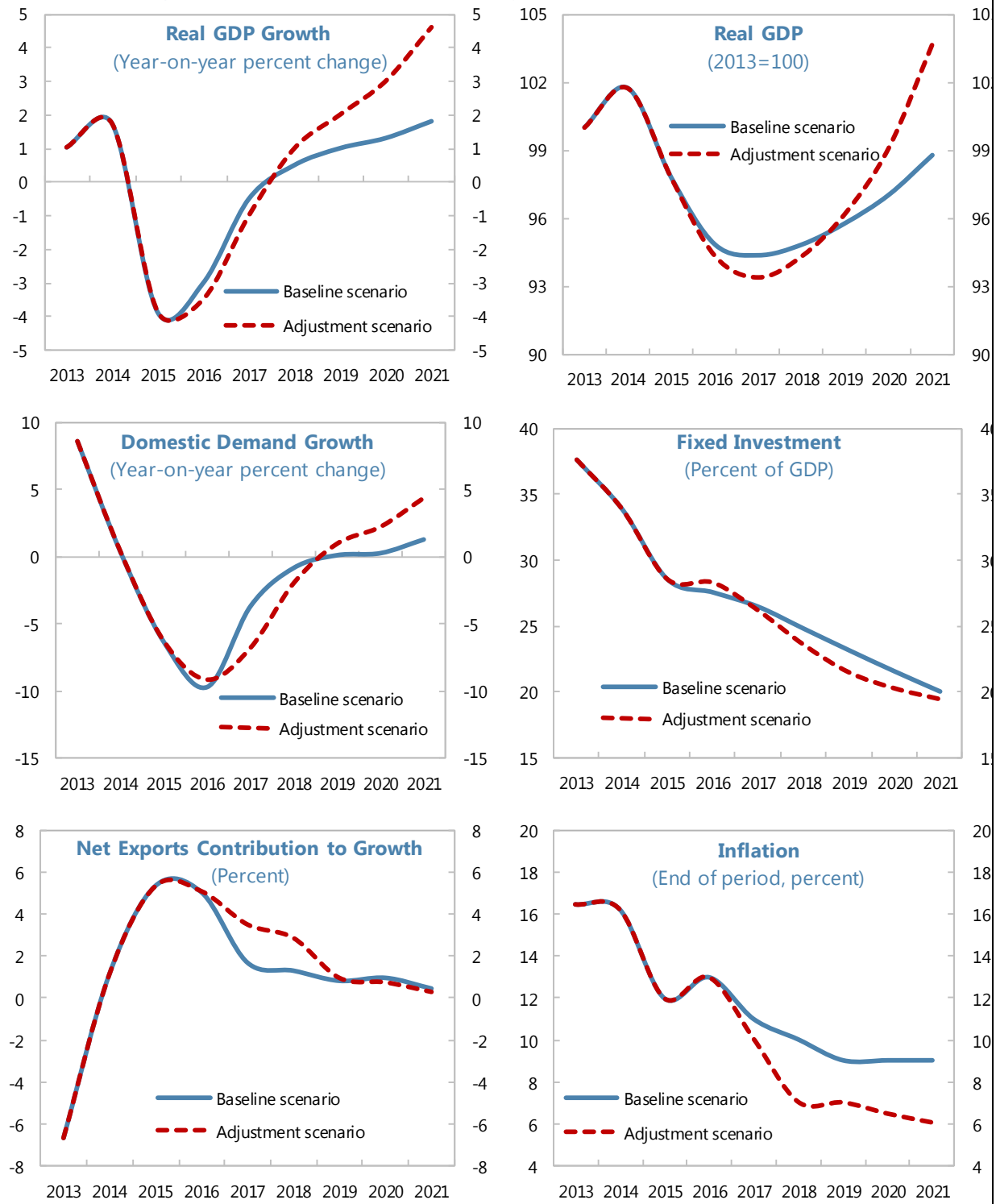


Household deposits have stabilized as currency pressures have eased and households adjust their consumption.



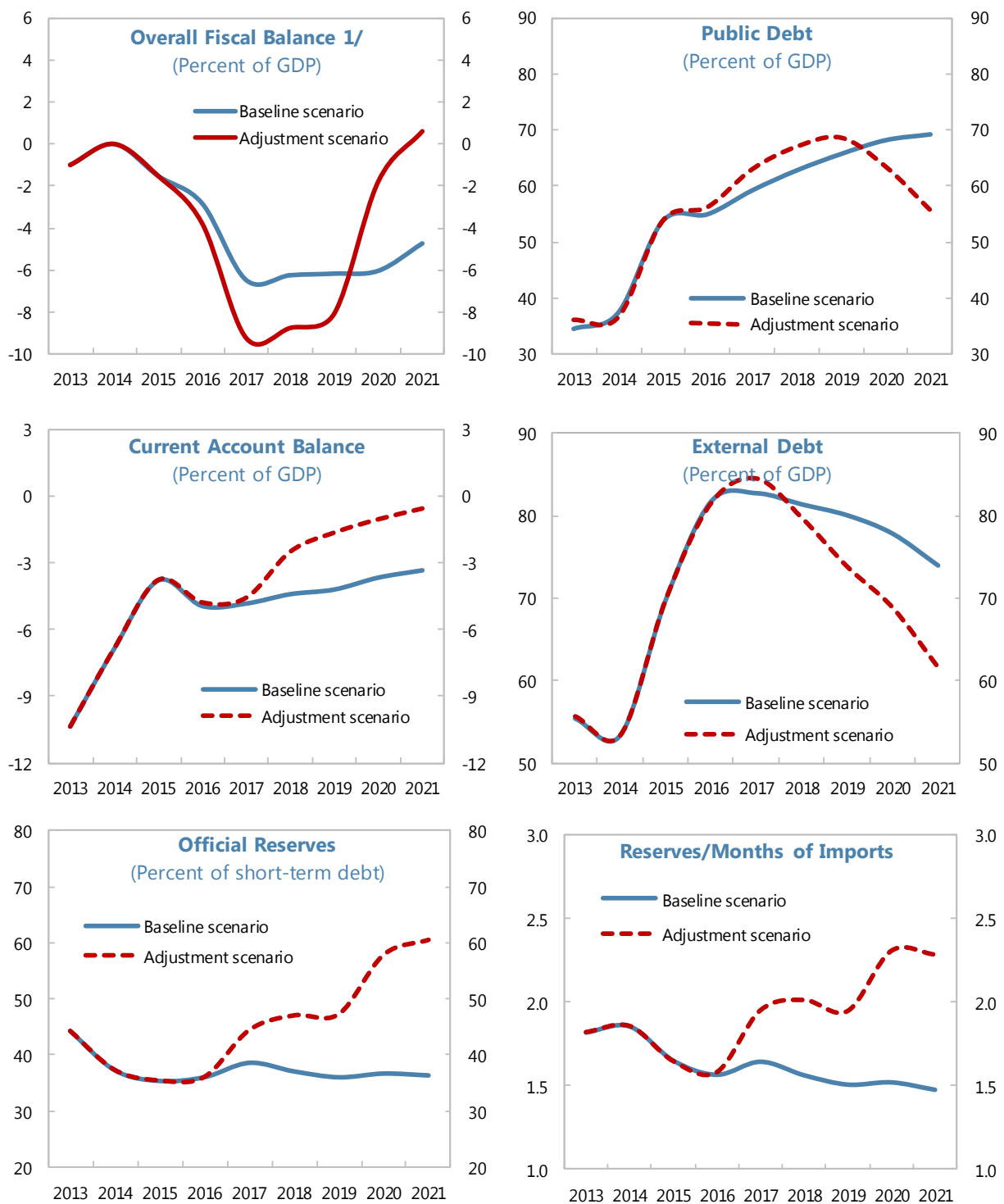
Sources: National Bank of the Republic of Belarus; and IMF staff estimates and calculations.

Figure 10. Belarus: Baseline and Adjustment Scenarios, 2013–21 /1



Sources: Belarusian authorities; and IMF staff estimates and calculations.

Figure 11. Belarus: Baseline and Adjustment Scenarios, 2013–21



Sources: Belarusian authorities; and IMF staff estimates and calculations.
 1/ Includes general government and off balance sheet operations.

Table 1a. Belarus: Selected Economic Indicators (Baseline Scenario), 2014–21

	2014	2015	2016	2017	2018	2019	2020	2021
	Proj.							
	(Percentage change)							
National accounts								
Real GDP	1.7	-3.9	-3.0	-0.5	0.5	1.0	1.3	1.8
Total domestic demand	0.3	-6.3	-9.7	-3.6	-0.8	0.1	0.3	1.3
Consumption	3.2	-2.0	-3.9	0.4	1.3	1.7	1.3	2.0
Nongovernment	4.3	-2.4	-2.5	0.4	1.5	1.7	1.4	2.4
Government	-2.0	-0.4	-11.0	0.2	0.2	1.3	0.9	-0.2
Investment	-5.0	-15.2	-23.4	-15.7	-8.2	-5.7	-3.9	-1.9
Net exports 1/	1.2	5.3	5.0	1.7	1.3	0.8	1.0	0.5
Consumer prices								
End of period	16.2	12.0	13.0	11.0	10.0	9.0	9.0	9.0
Average	18.1	13.5	12.7	12.0	9.7	9.3	8.9	9.0
GDP deflator	17.8	16.3	13.0	8.7	8.9	8.3	8.6	8.7
Monetary accounts								
Rubel base money	12.8	7.4	2.5	13.3	12.8	12.5	10.6	10.0
Broad money	23.6	36.8	15.0	13.5	12.5	11.0	10.5	10.0
	(Percent of GDP, unless otherwise indicated)							
External debt and balance of payments								
Current account balance	-6.9	-3.8	-4.9	-4.8	-4.4	-4.2	-3.7	-3.3
Trade balance	-3.5	-3.9	-6.6	-5.7	-5.3	-4.9	-4.2	-4.0
Exports of goods	46.5	48.0	47.9	50.4	50.2	50.1	49.8	49.6
Imports of goods	-50.0	-51.9	-54.5	-56.1	-55.5	-55.0	-54.0	-53.5
Gross external debt	52.6	70.1	81.8	82.7	81.4	80.1	77.8	74.0
Public 2/	23.1	31.9	38.3	41.7	40.2	39.5	38.4	36.0
Private (incl. state-owned-enterprises)	29.5	38.1	43.5	41.1	41.2	40.5	39.4	38.0
Net IIP	-55.0	-75.0	-88.5	-90.2	-90.9	-92.2	-91.9	-90.1
Savings and investment								
Gross domestic investment	35.6	30.0	26.9	23.6	21.8	20.5	19.4	18.7
Government	5.3	4.5	5.5	6.9	6.8	6.7	6.6	5.7
Nongovernment (incl. SOEs)	30.2	25.5	21.3	16.7	15.0	13.8	12.8	12.9
National saving 3/	28.7	26.2	21.9	18.8	17.4	16.3	15.7	15.3
Government	2.9	7.2	6.8	8.2	8.6	8.9	8.6	8.6
Nongovernment	25.8	19.0	15.1	10.5	8.8	7.3	7.2	6.7
Public sector finance								
State budget balance	0.7	2.3	-1.5	-3.1	-3.0	-3.0	-2.8	-1.5
State budget balance (excl. nuclear power plant, "NPP")	0.7	2.6	0.3	0.4	0.4	0.3	0.4	0.8
General government balance (incl. SPF)	0.7	1.9	-1.9	-3.6	-3.3	-3.3	-3.1	-1.8
Primary general government balance	2.0	3.6	0.4	-1.0	-0.5	0.1	0.5	1.8
Primary general government balance (excl. NPP)	2.0	4.0	2.3	2.6	2.9	3.4	3.8	4.2
Cyclically adjusted primary balance 4/	-1.4	5.7	4.2	5.6	5.6	5.3	5.1	4.7
Overall balance 5/	0.0	-1.5	-2.8	-6.5	-6.2	-6.1	-6.0	-4.7
Gross general government debt and guaranteed debt 6/	37.3	53.7	54.9	59.2	62.8	65.7	68.2	69.2
Of which: Public guarantees	12.5	14.5	14.5	14.5	14.5	14.5	14.5	14.5
Memorandum items:								
Nominal GDP (billions of U.S. dollars)	76	55	48	50	52	54	56	59
Nominal GDP (trillions of BYR)	778	870	953	1,031	1,129	1,235	1,359	1,504
Terms of trade, percentage change	2.2	-11.9	-8.9	-1.2	-1.2	-1.0	-0.7	-0.4
Real Effective Exchange Rate ("-" denotes a depreciation)	8.5	-9.2						
Nominal Effective Exchange Rate ("-" denotes a depreciation)	-3.8	-12.6						
Official reserves (billions of U.S. dollars)	5.1	4.2	4.2	4.5	4.4	4.4	4.5	4.6
Months of imports of goods and services	1.9	1.7	1.6	1.6	1.6	1.5	1.5	1.5
Percent of short-term debt	37.2	35.4	36.0	38.6	37.1	36.0	36.7	36.3
Quota (2016): SDR 681.5 million (950.8 million U.S. dollars)								

Sources: Belarusian authorities; and IMF staff estimates.

1/ Contribution to growth.

2/ Gross consolidated external debt of the public sector (central bank and general government debt including publicly guaranteed debt).

3/ The reduction in government saving and a corresponding increase in nongovernment saving include bank recapitalization and layouts related to public guaranteed debt.

4/ Cyclically adjusted; excluding NPP; including net new directed lending.

5/ Includes general government and off balance sheet operations.

6/ Consolidated debt of the non-financial public sector (general government debt including publicly guaranteed debt).

Table 1b. Belarus: Selected Economic Indicators (Adjustment Scenario), 2014–21

	2014	2015	2016	2017	2018	2019	2020	2021
	Proj.							
	(Percentage change)							
National accounts								
Real GDP	1.7	-3.9	-3.5	-1.0	1.0	2.0	3.0	4.6
Total domestic demand	0.3	-6.3	-9.2	-6.8	-2.0	1.0	2.2	4.4
Consumption	3.2	-2.0	-3.2	-0.6	1.5	2.3	2.7	2.2
Nongovernment	4.3	-2.4	-2.7	-0.5	1.5	1.9	2.5	2.7
Government	-2.0	-0.4	-6.2	-1.3	1.1	4.0	3.5	-0.4
Investment	-5.0	-15.2	-23.3	-25.4	-15.7	-5.3	-0.1	16.0
Net exports 1/	1.2	5.3	5.1	3.5	2.9	1.0	0.8	0.3
Consumer prices								
End of period	16.2	12.0	13.0	10.0	7.0	7.0	6.5	6.0
Average	18.1	13.5	13.0	10.8	7.7	6.4	6.8	6.0
GDP deflator	17.8	16.3	14.8	4.6	6.9	6.8	6.4	5.6
Monetary accounts								
Rubel base money	12.8	7.4	0.0	14.0	13.6	13.4	11.5	10.4
Broad money	23.6	36.8	13.8	12.5	12.0	11.3	10.6	10.0
	(Percent of GDP, unless otherwise indicated)							
External debt and balance of payments								
Current account balance	-6.9	-3.8	-4.8	-4.6	-2.5	-1.7	-1.1	-0.6
Trade balance	-3.5	-3.9	-6.5	-5.4	-3.2	-2.2	-1.6	-1.4
Exports of goods	46.5	48.0	47.5	51.4	51.1	50.5	50.1	48.5
Imports of goods	-50.0	-51.9	-54.0	-56.7	-54.3	-52.7	-51.7	-50.0
Gross external debt	52.6	70.1	81.5	84.4	79.7	73.8	68.8	61.6
Public 2/	23.1	31.9	38.3	42.3	40.2	37.7	35.1	31.0
Private (incl. state-owned-enterprises)	29.5	38.1	43.2	42.2	39.5	36.1	33.7	30.6
Net IIP	-55.0	-75.0	-87.5	-91.3	-89.0	-85.0	-80.4	-73.8
Savings and investment								
Gross domestic investment	35.6	30.0	26.7	21.6	18.3	17.0	16.4	17.8
Government	5.3	4.5	5.5	7.8	7.7	7.6	7.6	6.6
Nongovernment (incl. SOEs)	30.2	25.5	21.2	13.8	10.6	9.3	8.8	11.2
National saving 3/	28.7	26.2	21.9	17.0	15.8	15.3	15.3	17.2
Government	2.9	7.2	6.0	7.5	8.6	9.6	10.6	11.5
Nongovernment	25.8	19.0	15.8	9.5	7.2	5.7	4.7	5.8
Public sector finance								
State budget balance	0.7	2.3	-2.0	-4.2	-3.7	-2.7	-1.4	1.0
State budget balance (excl. nuclear power plant, "NPP")	0.7	2.6	-0.1	-0.6	-0.2	0.5	1.7	3.2
General government balance (incl. SPF)	0.7	1.9	-2.6	-5.4	-4.5	-3.4	-1.8	0.6
Primary general government balance	2.0	3.6	-0.3	-2.6	-1.2	0.6	2.6	4.7
Primary general government balance (excl. NPP)	2.0	4.0	1.5	1.0	2.2	3.8	5.7	6.8
Cyclically adjusted primary balance 4/	-0.8	2.0	2.7	3.9	4.9	6.3	7.5	7.7
Overall balance 5/	0.0	-1.5	-3.8	-9.2	-8.7	-8.1	-1.8	0.6
Gross public debt and government guaranteed debt 6/	36.5	53.7	56.1	62.9	66.9	68.5	63.4	55.6
Of which: Public guarantees	12.5	14.5	12.7	10.9	9.1	7.3	5.4	3.6
Memorandum items:								
Nominal GDP (billions of U.S. dollars)	76	55	49	49	51	55	59	64
Nominal GDP (trillions of rubels)	778	870	964	998	1,078	1,175	1,287	1,422
Terms of trade, percentage change	2.2	-11.9	-8.8	-3.4	-1.0	-0.4	-0.3	0.0
Real Effective Exchange Rate ("-" denotes a depreciation)	8.5	-9.2						
Nominal Effective Exchange Rate ("-" denotes a depreciation)	-3.8	-12.6						
Official reserves (billions of U.S. dollars)	5.1	4.2	4.2	5.2	5.6	5.7	7.1	7.6
Months of imports of goods and services	1.9	1.6	1.6	2.0	2.0	1.9	2.3	2.3
Percent of short-term debt	37.2	35.4	36.0	44.4	47.1	47.3	58.0	60.6
Quota (2016): SDR 681.5 million (950.8 million U.S. dollars)								

Sources: Belarusian authorities; and IMF staff estimates.

1/ Contribution to growth.

2/ Gross consolidated external debt of the public sector (central bank and general government debt including publicly guaranteed debt).

3/ The reduction in government saving and a corresponding increase in nongovernment saving include bank recapitalization and layouts related to public guaranteed debt.

4/ Cyclically adjusted; excluding NPP; including net new directed lending.

5/ Includes general government and off balance sheet operations.

6/ Consolidated debt of the public sector (central bank and general government debt including publicly guaranteed debt).

Table 2. Belarus: Balance of Payments (Baseline), 2014–21 1/
(Billions of U.S. dollars, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021
			Proj.					
Current account balance	-5.2	-2.1	-2.4	-2.4	-2.3	-2.3	-2.1	-2.0
Trade balance (goods)	-2.6	-2.1	-3.2	-2.8	-2.7	-2.6	-2.4	-2.3
Energy balance	-0.4	-1.6	-2.7	-2.8	-2.9	-3.0	-2.9	-3.0
Nonenergy balance	-2.3	-0.6	-0.5	0.0	0.2	0.3	0.5	0.7
Exports	35.4	26.2	23.0	25.0	25.8	26.9	27.9	29.0
Energy	11.4	7.6	6.0	6.7	6.9	7.1	7.3	7.5
Nonenergy	24.1	18.6	17.0	18.3	19.0	19.8	20.6	21.5
Imports	-38.1	-28.3	-26.2	-27.8	-28.6	-29.5	-30.3	-31.3
Energy	-11.7	-9.1	-8.7	-9.5	-9.8	-10.1	-10.2	-10.5
Nonenergy	-26.3	-19.2	-17.5	-18.3	-18.8	-19.4	-20.0	-20.8
Services, net	2.2	2.3	2.2	2.2	2.2	2.2	2.2	2.3
Receipts	7.9	6.6	6.3	6.3	6.4	6.4	6.5	6.6
Payments	-5.7	-4.3	-4.1	-4.2	-4.2	-4.2	-4.3	-4.4
Income, net	-2.4	-2.5	-1.8	-2.3	-2.2	-2.4	-2.5	-2.6
Transfers, net	-2.3	0.3	0.4	0.5	0.5	0.6	0.6	0.7
<i>of which: oil export duty transfer to Russia</i>	-3.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital and financial accounts	4.4	0.9	1.0	2.0	2.0	2.2	2.2	2.1
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	4.4	0.8	1.0	2.0	2.0	2.2	2.2	2.1
Overall FDI, net	1.8	1.5	1.4	1.3	1.3	1.5	1.6	2.1
Portfolio investment, net	0.0	-1.0	0.0	0.8	-0.8	0.0	0.0	0.0
<i>of which: Eurobond issue (gross)</i>	0.0	0.0	0.0	0.8	0.0	0.0	0.0	0.0
Trade credits, net	0.3	-0.1	0.0	0.1	0.2	0.2	0.3	0.4
Loans, net	1.7	1.7	0.0	0.1	1.4	0.8	0.5	-0.6
Government and monetary authorities, net	2.3	2.4	0.2	0.8	0.7	0.5	0.4	-0.4
<i>of which: from Russia, net</i>	1.5	0.5	-0.3	-0.4	-0.5	-0.6	-0.6	-1.3
<i>of which: from EFSD (former ACF), repayments</i>	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.2
Banks, net	-1.4	-1.5	0.0	-0.6	0.4	0.3	0.0	0.1
Other sectors, net	0.8	0.8	-0.3	-0.1	0.3	0.0	0.1	-0.3
Other, net	0.6	-1.2	-0.4	-0.3	-0.2	-0.3	-0.1	0.2
Errors and omissions	-1.3	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.1	-0.5	-1.4	-0.4	-0.3	-0.1	0.2	0.1
Financing	2.1	0.5	1.4	0.4	0.3	0.1	-0.2	-0.1
Gross official reserves ("-" denotes an increase)	1.4	0.6	0.3	-0.3	0.1	0.1	-0.2	-0.1
Use of IMF credit (+)	-1.3	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other donors and exceptional financing items	2.0	0.0	1.1	0.7	0.2	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Total external debt (in percent of GDP)	52.6	70.1	81.8	82.7	81.4	80.1	77.8	74.0
Gross official reserves (end-of-period, billions of U.S. dollars)	5.1	4.2	4.2	4.5	4.4	4.4	4.5	4.6
In months of imports of goods and services	1.9	1.7	1.6	1.6	1.6	1.5	1.5	1.5
In percent of short-term debt	37.2	35.4	36.0	38.6	37.1	36.0	36.7	36.3
In percent of GIR/ARA EM metric (fixed exchange rate regime)	31.7	29.8	30.5	31.6	30.1	28.9	29.2	29.5
In percent of GIR/ARA EM metric (flexible exchange rate regime)	42.6	39.9	40.8	42.6	40.6	39.2	39.7	40.3
Real effective exchange rate ("+" denotes appreciation)	8.5	-9.2	-9.6	0.0	0.0	0.0	0.0	0.0
Export volume (annual percentage change)	2.2	2.4	0.8	-1.0	0.1	0.7	1.2	1.2
Import volume (annual percentage change)	2.6	-11.3	-5.7	-2.9	-1.6	-0.6	-0.3	0.5
Natural gas import prices for Belarus (US\$ per thousands m3)	170.1	144.5	133.0	133.0	136.0	140.0	143.8	147.7
Natural Gas, Russian Natural Gas border price in Germany (US\$ per thousands m3)	386.2	269.7	154.6	149.1	149.1	149.1	149.1	149.1
Oil import prices for Belarus (US\$ per barrel)	48.3	34.2	30.3	36.6	38.8	40.4	41.8	43.0
World market oil prices (WEO, US\$ per barrel)	96.2	50.8	42.3	49.4	52.3	54.5	56.4	58.0

Sources: Belarus authorities; and IMF staff estimates.

1/ Data compiled based on BPM6.

Table 2. Belarus: Balance of Payments (Baseline), 2014–21 1/ (concluded)

(Percent of GDP, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021
			Proj.					
Current account balance	-6.9	-3.8	-4.9	-4.8	-4.4	-4.2	-3.7	-3.3
Trade balance (goods)	-3.5	-3.9	-6.6	-5.7	-5.3	-4.9	-4.2	-4.0
Energy balance	-0.5	-2.8	-5.7	-5.7	-5.7	-5.5	-5.2	-5.1
Nonenergy balance	-3.0	-1.1	-0.9	0.1	0.4	0.6	1.0	1.1
Exports	46.5	48.0	47.9	50.4	50.2	50.1	49.8	49.6
Energy	14.9	13.9	12.5	13.5	13.3	13.3	13.1	12.9
Nonenergy	31.6	34.1	35.4	37.0	36.8	36.9	36.7	36.7
Imports	-50.0	-51.9	-54.5	-56.1	-55.5	-55.0	-54.0	-53.5
Energy	-15.4	-16.7	-18.1	-19.2	-19.0	-18.8	-18.3	-18.0
Nonenergy	-34.6	-35.2	-36.4	-36.9	-36.4	-36.2	-35.7	-35.6
Services, net	2.8	4.2	4.5	4.4	4.2	4.1	4.0	3.9
Receipts	10.4	12.2	13.0	12.7	12.4	12.0	11.7	11.3
Payments	-7.5	-7.9	-8.5	-8.4	-8.2	-7.9	-7.7	-7.5
Income, net	-3.2	-4.7	-3.8	-4.5	-4.3	-4.5	-4.5	-4.4
Transfers, net	-3.1	0.5	0.9	1.0	1.0	1.1	1.1	1.2
<i>of which:</i> oil export duty transfer to Russia	-4.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital and financial accounts	5.7	1.6	2.0	4.1	3.8	4.1	3.9	3.5
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	5.7	1.6	2.0	4.1	3.8	4.1	3.9	3.5
Overall FDI, net	2.4	2.7	3.0	2.7	2.6	2.7	2.9	3.6
Portfolio investment, net	0.0	-1.8	0.0	1.6	-1.6	0.0	0.0	0.0
<i>of which:</i> Eurobond issue (gross)	0.0	0.0	0.0	1.6	0.0	0.0	0.0	0.0
Trade credits, net	0.4	-0.2	0.0	0.3	0.4	0.4	0.5	0.7
Loans, net	2.2	3.1	-0.1	0.2	2.7	1.5	0.8	-1.1
Government and monetary authorities, net	3.1	4.5	0.4	1.6	1.4	1.0	0.7	-0.7
<i>of which:</i> from Russia, net	2.0	0.8	-0.6	-0.7	-0.9	-1.2	-1.2	-2.2
<i>of which:</i> from EFSD (former ACF), repayments	-0.3	-0.6	-0.7	-0.7	-0.7	-0.7	-0.6	-0.3
Banks, net	-1.9	-2.8	0.1	-1.1	0.7	0.6	0.0	0.1
Other sectors, net	1.0	1.4	-0.5	-0.2	0.6	-0.1	0.2	-0.6
Other, net	0.8	-2.2	-0.9	-0.7	-0.4	-0.5	-0.2	0.3
Errors and omissions	-1.7	1.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.8	-1.0	-2.9	-0.8	-0.6	-0.1	0.3	0.2
Financing	2.8	1.0	2.9	0.8	0.6	0.1	-0.3	-0.2
Gross official reserves ("-" denotes an increase)	1.9	1.1	0.6	-0.7	0.2	0.1	-0.3	-0.2
Use of IMF credit (+)	-1.7	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other donors and exceptional financing items	2.6	0.0	2.3	1.4	0.4	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Total external debt (in percent of GDP)	52.6	70.1	81.8	82.7	81.4	80.1	77.8	74.0
Gross official reserves (end-of-period, billions of U.S. dollars)	5.1	4.2	4.2	4.5	4.4	4.4	4.5	4.6
In months of imports of goods and services	1.9	1.7	1.6	1.6	1.6	1.5	1.5	1.5
In percent of short-term debt	37.2	35.4	36.0	38.6	37.1	36.0	36.7	36.3
In percent of GIR/ARA EM metric (fixed exchange rate regime)	31.7	29.8	30.5	31.6	30.1	28.9	29.2	29.5
In percent of GIR/ARA EM metric (flexible exchange rate regime)	42.6	39.9	40.8	42.6	40.6	39.2	39.7	40.3
Real effective exchange rate ("+" denotes appreciation)	8.5	-9.2	-9.6	0.0	0.0	0.0	0.0	0.0
Export volume (annual percentage change)	2.2	2.4	0.8	-1.0	0.1	0.7	1.2	1.2
Import volume (annual percentage change)	2.6	-11.3	-5.7	-2.9	-1.6	-0.6	-0.3	0.5
Natural gas import prices for Belarus (US\$ per thousands m3)	170.1	144.5	133.0	133.0	136.0	140.0	143.8	147.7
Natural Gas, Russian Natural Gas border price in Germany (US\$ per thousands m3)	386.2	269.7	154.6	149.1	149.1	149.1	149.1	149.1
Oil import prices for Belarus (US\$ per barrel)	48.3	34.2	30.3	36.6	38.8	40.4	41.8	43.0
World market oil prices (WEO, US\$ per barrel)	96.2	50.8	42.3	49.4	52.3	54.5	56.4	58.0

Sources: Belarus authorities; and IMF staff estimates.

1/ Data compiled based on BPM6.

Table 3. Belarus: Fiscal Indicators and Projections (Baseline), 2014–21
(Trillions of BYR, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021
			Proj.					
1. State (republican and local) budget								
Revenues	219	266	266	291	320	352	389	433
Tax revenues	189	223	234	257	283	311	344	384
Personal income tax	32	37	39	42	46	50	56	61
Profit tax	20	22	17	20	24	27	32	38
VAT	70	73	83	90	98	107	118	131
Excises	21	19	22	25	28	30	34	37
Property tax	10	12	16	17	19	20	22	25
Customs duties	18	39	35	39	42	47	51	57
of which : oil export duties to Russia retained	0	18	15	16	18	20	22	24
Other tax revenues	18	20	22	24	26	29	32	35
Non tax revenues	30	44	32	34	37	41	45	49
of which : from SoEs	14	22	8	9	9	10	11	12
Expenditure (economic classification)	214	247	281	323	354	389	428	456
Wages and salaries	53	61	67	75	82	90	98	107
Social protection fund contributions	15	17	18	20	22	24	26	29
Goods and services	38	48	55	60	66	71	78	86
Interest	10	15	22	27	32	42	50	55
Subsidies and transfers	57	66	67	70	74	79	85	93
of which: subsidies for utilities	9	10	8	4	0	0	0	0
of which: interest rate subsidy	14	13	13	11	10	9	7	7
of which: transfers to households (incl. increase in tariffs on utilities)	18	22	27	34	41	45	50	55
Capital expenditures	41	39	53	71	77	83	90	86
excl. Nuclear Power Plant (NPP)	41	36	35	35	38	42	46	51
State Budget Balance	5	20	-15	-32	-33	-37	-38	-23
State Budget Balance (excl. NPP)	5	23	3	5	5	4	6	12
2. Social protection fund								
Revenue	94	105	115	124	136	149	164	181
Expenditure	94	108	118	129	140	152	168	186
of which: unemployment benefits	0	0	0	1	1	1	2	2
of which: pension	74	84	94	101	109	118	130	144
Balance (cash)	0	-3	-3	-5	-4	-3	-4	-5
3. General government								
Revenue	299	354	358	389	427	469	518	577
Expenditure	294	338	375	426	465	509	561	604
Balance	5	16	-18	-37	-38	-40	-43	-28
Primary balance	15	31	4	-10	-6	1	7	28
Primary balance (excl. NPP)	15	35	22	26	33	42	52	63
Cyclically adjusted primary balance 1/	-11	50	40	58	64	66	70	70
Off-Balance sheet operations	-6	-30	-9	-30	-33	-36	-39	-43
of which: Central bank equity recap	0	0	0	0	0	0	0	0
Overall balance 2/	0	-13	-27	-67	-70	-76	-82	-71
4. Financing (cash)								
Privatization	2	2	2	2	2	2	3	3
Foreign financing, net	-11	-10	14	39	2	15	34	-10
Domestic financing, net	23	71	12	26	66	58	46	78
Memorandum items:								
Gross general government debt and guaranteed debt	290	467	524	610	709	812	927	1,041
Of which: Public guarantees	97	126	138	150	164	179	197	218
Net general government debt and guaranteed debt 3/	290	363	394	461	550	647	755	862
GDP (trillions of Belarusian rubels)	778	870	953	1,031	1,129	1,235	1,359	1,504

Sources: Ministry of Finance; SPF; and IMF staff estimates.

1/ Cyclically adjusted; excluding NPP; including net new directed lending.

2/ Includes general government and off balance sheet operations.

3/ Equals gross debt minus government deposits, excluding deposits at the Development Bank.

Table 3. Belarus: Fiscal Indicators and Projections (Baseline), 2014–21 (concluded)

(Percent of GDP, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021
			Proj.					
1. State (republican and local) budget								
Revenue	28.2	30.6	27.9	28.2	28.4	28.5	28.6	28.8
Tax revenues	24.3	25.6	24.6	24.9	25.1	25.2	25.3	25.5
Personal income tax	4.1	4.3	4.1	4.1	4.1	4.1	4.1	4.1
Profit tax	2.6	2.5	1.8	2.0	2.1	2.2	2.4	2.5
VAT	9.0	8.4	8.7	8.7	8.7	8.7	8.7	8.7
Excises	2.7	2.2	2.3	2.4	2.4	2.5	2.5	2.5
Property tax	1.2	1.4	1.6	1.6	1.6	1.6	1.6	1.6
Customs duties	2.4	4.5	3.7	3.8	3.8	3.8	3.8	3.8
of which : oil export duties to Russia retained	0.0	2.0	1.5	1.6	1.6	1.6	1.6	1.6
Other tax revenues	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Non tax revenues	3.9	5.0	3.4	3.3	3.3	3.3	3.3	3.3
of which : from SoEs	1.8	2.5	0.9	0.8	0.8	0.8	0.8	0.8
Expenditure (economic classification)	27.5	28.3	29.5	31.3	31.3	31.5	31.5	30.3
Wages and salaries	6.9	7.0	7.0	7.3	7.3	7.3	7.2	7.1
Social protection fund contributions	1.9	1.9	1.9	2.0	2.0	2.0	1.9	1.9
Goods and services	4.9	5.5	5.7	5.8	5.8	5.7	5.7	5.7
Interest	1.3	1.7	2.3	2.6	2.8	3.4	3.7	3.7
Subsidies and transfers	7.3	7.6	7.0	6.8	6.6	6.4	6.3	6.2
of which: utilities subsidies	1.1	1.2	0.8	0.4	0.0	0.0	0.0	0.0
of which: interest rate subsidy (directed lending)	1.7	1.5	1.3	1.1	0.9	0.7	0.5	0.4
of which: transfers to households (incl. utility tariff increases)	2.4	2.6	2.9	3.3	3.7	3.7	3.7	3.7
Capital expenditures	5.3	4.5	5.5	6.9	6.8	6.7	6.6	5.7
excl. Nuclear Power Plant (NPP)	5.3	4.2	3.7	3.4	3.4	3.4	3.4	3.4
State Budget Balance	0.7	2.3	-1.5	-3.1	-3.0	-3.0	-2.8	-1.5
State Budget Balance (excl. NPP)	0.7	2.6	0.3	0.4	0.4	0.3	0.4	0.8
2. Social Protection Fund								
Revenue	12.1	12.0	12.0	12.0	12.0	12.0	12.0	12.0
Expenditure	12.1	12.4	12.4	12.5	12.4	12.3	12.4	12.4
of which: unemployment benefits	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1
of which: pensions	9.6	9.7	9.8	9.8	9.7	9.6	9.6	9.6
Balance (cash)	0.0	-0.4	-0.3	-0.5	-0.4	-0.3	-0.3	-0.3
3. General government								
Revenue	38.4	40.7	37.5	37.7	37.8	38.0	38.1	38.3
Expenditure	37.7	38.8	39.4	41.3	41.2	41.2	41.3	40.2
Balance	0.7	1.9	-1.9	-3.6	-3.3	-3.3	-3.1	-1.8
Primary balance	2.0	3.6	0.4	-1.0	-0.5	0.1	0.5	1.8
Primary balance (excl. NPP)	2.0	4.0	2.3	2.6	2.9	3.4	3.8	4.2
Cyclically adjusted primary balance 1/	-1.4	5.7	4.2	5.6	5.6	5.3	5.1	4.7
Off-Balance sheet operations	-0.7	-3.4	-1.0	-2.9	-2.9	-2.9	-2.9	-2.9
of which: Central bank equity recap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance 2/	0.0	-1.5	-2.8	-6.5	-6.2	-6.1	-6.0	-4.7
4. Financing (cash)								
Privatization	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Foreign financing, net	-1.4	-1.2	1.4	3.7	0.2	1.2	2.5	-0.7
Domestic financing, net	3.0	8.2	1.2	2.5	5.9	4.7	3.4	5.2
Memorandum items:								
Gross general government debt and guaranteed debt	37.3	53.7	54.9	59.2	62.8	65.7	68.2	69.2
Of which: Public guarantees	12.5	14.5	14.5	14.5	14.5	14.5	14.5	14.5
Net general government debt and guaranteed debt 3/	37.3	41.8	41.3	44.7	48.7	52.4	55.6	57.3
GDP (trillions of Belarusian rubels)	778	870	953	1,031	1,129	1,235	1,359	1,504

Sources: Ministry of Finance; SPF; and IMF staff estimates.

1/ Cyclically adjusted; excluding NPP; including net new directed lending.

2/ Includes general government and off balance sheet operations.

3/ Equals gross debt minus government deposits, excluding deposits at the Development Bank.

Table 4. Belarus: Monetary Accounts (Baseline), 2014–2021
(Trillions of BYR, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021
						Projections		
Monetary survey								
Net foreign assets	-40.3	-41.5	-35.1	-6.4	-8.7	-7.1	7.4	8.0
(In billions of U.S. dollars)	-3.4	-2.2	-1.8	-0.3	-0.4	-0.3	0.3	0.3
Net domestic assets	279.2	368.4	411.0	433.2	488.7	539.9	581.3	639.3
Net Domestic credit	291.3	376.0	402.3	439.6	512.1	604.3	675.7	759.3
Net claims on government	-53.8	-33.6	-45.4	-52.2	-34.2	1.3	8.0	18.2
Claims on government	38.8	70.5	69.1	81.3	109.3	150.8	164.0	181.8
Liabilities to government	92.6	104.1	114.4	133.5	143.4	149.5	156.0	163.6
Net Credit to the economy	345.1	409.6	447.6	491.9	546.3	603.0	667.7	741.1
Domestic currency	169.9	178.8	232.6	258.4	296.0	337.1	382.5	436.2
Foreign currency	175.2	230.8	215.1	233.5	250.3	266.0	285.2	304.9
Other items, net	-12.0	-7.6	8.8	-6.5	-23.4	-64.4	-94.4	-120.0
Broad money	239.0	326.9	376.0	426.7	480.0	532.8	588.7	647.4
Accounts of the NBRB								
Net foreign assets	32.8	45.0	60.1	75.8	80.8	87.2	99.2	107.6
(In billions of U.S. dollars)	2.8	2.4	3.0	3.6	3.7	4.2	4.5	4.6
Foreign assets	66.1	86.8	91.0	102.4	105.6	109.9	119.3	128.9
of which: Gross international reserves	60.0	77.5	82.7	93.7	96.4	100.3	109.2	118.2
(In billions of U.S. dollars)	5.1	4.2	4.2	4.5	4.4	4.4	4.5	4.6
Foreign liabilities	33.4	41.9	30.9	26.6	24.7	22.7	20.2	21.4
(In billions of U.S. dollars)	2.7	2.3	1.6	1.3	1.1	1.0	0.8	0.8
Net domestic assets	6.4	0.0	-14.8	-25.3	-24.8	-25.5	-31.6	-33.6
Net domestic credit	-8.1	0.0	-56.4	-76.3	-86.1	-92.2	-98.0	-105.6
Net claims on government	-33.2	-47.2	-72.3	-90.8	-100.1	-105.5	-111.3	-118.1
Net claims on the economy	8.8	4.1	1.6	1.6	1.6	1.6	1.6	1.6
Credit to banks	16.3	16.9	14.3	12.9	12.4	11.8	11.7	10.9
Other items, net	14.0	0.0	41.5	51.0	61.3	66.6	66.4	72.0
Base money	39.1	45.0	45.3	50.5	56.1	61.7	67.6	74.0
Rubel Base money	37.5	40.3	41.3	46.8	52.8	59.4	65.6	72.2
Non-Rubel Base money	1.6	4.7	4.0	3.7	3.3	2.3	1.9	1.8
Currency in circulation	13.9	14.2	17.1	19.5	22.1	25.0	28.0	29.0
Banks' reserves	25.2	30.7	28.2	31.0	33.9	36.6	39.6	45.0
Deposit money banks								
Net foreign assets	-73.0	-86.5	-95.2	-82.3	-89.6	-94.3	-91.8	-99.6
(In billions of U.S. dollars)	-6.2	-4.7	-4.8	-4.0	-4.1	-4.1	-3.8	-3.9
Foreign assets	14.1	32.9	37.9	45.5	52.7	63.0	73.5	77.6
(In billions of U.S. dollars)	1.2	1.8	1.9	2.2	2.4	2.7	3.0	3.0
Foreign liabilities	87.2	119.4	133.1	127.8	142.3	157.2	165.3	177.2
(In billions of U.S. dollars)	7.4	6.4	6.7	6.1	6.5	6.8	6.8	6.9
Net domestic assets	298.1	398.6	454.1	489.5	547.4	602.1	652.5	717.9
Net domestic credit	362.2	486.7	539.4	585.5	660.6	754.2	826.4	926.6
Net claims on government	-21.0	13.5	26.9	38.5	65.9	106.8	119.3	136.3
Net credit to the economy	336.3	405.5	446.0	490.3	544.7	601.5	666.1	739.5
Public nonfinancial corporation	161.1	189.1	211.9	230.4	255.5	280.9	309.7	342.0
Private sector	178.2	215.5	231.9	257.9	287.6	319.4	355.7	397.1
Nonbank financial institutions	-3.0	0.9	2.2	2.0	1.6	1.2	0.7	0.4
Net claims on NBRB	47.0	67.7	66.4	56.7	50.0	46.0	41.0	50.9
Other items, net	-64.1	-88.1	-85.4	-96.0	-113.2	-152.1	-173.9	-208.7
Banks' liabilities included in broad money	225.0	312.1	358.9	407.2	457.8	507.8	560.7	618.4
Memorandum items: (Percent change, unless otherwise indicated)								
Base money	13.8	14.9	0.7	11.6	10.9	10.0	9.6	9.5
Rubel base money	12.8	7.4	2.5	13.3	12.8	12.5	10.6	10.0
Broad money	23.6	36.8	15.0	13.5	12.5	11.0	10.5	10.0
Net credit to the economy	22.2	18.7	9.3	9.9	11.1	10.4	10.7	11.0
Real net credit to economy	5.1	6.0	-3.3	-1.0	1.0	1.3	1.6	1.8
Credit to private sector	23.9	20.9	7.6	11.1	11.5	11.0	11.4	11.6
Real credit to private sector	6.6	8.0	-4.8	0.1	1.4	1.9	2.2	2.4
Velocity of broad money, ratio	3.3	2.7	2.5	2.4	2.3	2.3	2.3	2.3
Money multiplier, ratio	6.1	7.3	8.3	8.4	8.6	8.6	8.7	8.7
Deposit dollarization, ratio	64.4	74.6	77.2	76.8	76.7	76.3	76.0	75.4
Bank holdings of public FX debt								
(In billions of U.S. dollars)	2.2	4.8	5.5	4.7	4.1	3.7	3.3	3.4
of which: NBRB	0.3	1.9	2.6	1.9	1.3	0.9	0.5	0.6
of which: Government	1.9	2.9	2.8	2.8	2.8	2.8	2.8	2.8
BYR per U.S. dollar, eop	11,850	18,569	...	...	...	...	...	...
CPI eop	16.2	12.0	13.0	11.0	10.0	9.0	9.0	9.0

Sources: National Bank of the Republic of Belarus; and IMF staff estimates and projections.

Table 5. Belarus: Financial Soundness Indicators, 2010–2016 1/

	2010	2011	2012	2013	2014	2015				2016
	Dec	Dec	Dec	Dec	Dec	Mar	Jun	Sep	Dec	Mar
Capital adequacy										
Capital adequacy ratio 2/	20.5	24.7	20.8	15.5	17.4	17.2	16.8	19.2	18.7	16.3
Tier I capital adequacy ratio 2/	16.4	20.4	16.2	11.5	12.9	13.7	13.2	15.3	14.7	13.4
Foreign exchange loans to total loans	21.7	39.5	45.5	51.3	52.3	57.0	59.1	60.3	58.1	60.4
Non-performing loans to gross loans	3.5	4.2	5.5	4.4	4.4	5.1	5.5	6.5	6.8	11.5
Provisions to non-performing loans	35.3	37.2	33.8	38.9	37.2	37.0	...	...	...	...
Return on Assets	2.1	2.1	2.2	2.3	2.1	1.8	1.7	1.7	1.3	1.4
Return on Equity	14.6	19.1	14.8	16.2	15.3	13.7	13.3	13.5	10.4	11.4

Source: National Bank of the Republic of Belarus.

1/ Official statistics do not adequately reflect risks because of pervasive evergreening and reporting weaknesses. Indicators do not include the DB.

2/ CARs increased in December 2014 on account of reversing an increase in risk weights for FX assets that was introduced in October 2013.

Annex I. Responses to Past Policy Recommendations¹

IMF 2015 Article IV Recommendations	Authorities' Responses
Fiscal Policy (Broadly Consistent)	
<p>Slow directed lending in the near term and then reduce and phase it out entirely.</p>	<p>The authorities have begun reducing the stock of directed lending, beginning with a 1.6 percent of GDP cut in 2016, with planned cuts of 2.1 percent of GDP in 2017 and 2.2 percent of GDP in 2018. A March 2016 decree on state financial support is aimed at introducing more competition and efficiency in the use of financial resources.</p>
<p>Keep nominal wages constant in 2015 to reduce real wages (following the excessive growth of past years). Medium-term wage developments should be closely linked to productivity.</p>	<p>Nominal growth of wages in 2015 was 10 percent. The decline in real wages exceeded the decline in productivity. The growth of wages at state-owned organizations has been linked to productivity growth by government resolution. Under the 2016-20 Government Action Plan, real wages dynamics in all sectors will be monitored, aiming to keep real wage growth at no more than productivity.</p>
<p>Oil-duty windfalls should be saved in full to run a state budget surplus. Even larger budget surpluses will be appropriate if directed lending is not sharply reduced. Further fiscal savings should be achieved over the medium term by containing growth of the public sector wage bill and reducing subsidies and transfers.</p>	<p>The 2015 state budget had a surplus of 1.8% of GDP, used to repay debt. The use of oil-duty revenues to repay FX-denominated government debt is included in the 2016 budget. The growth of the wage bill for budgetary organizations in 2016–17 is linked to (no more than) targeted inflation. Any real growth of wages and salaries in budgetary organizations over the medium-term should only happen under staff optimization. Fiscal savings are planned by cutting expenses on capital investment and in government agencies, reducing compensation of interest on directed loans and reducing tax exemptions.</p>
Monetary Policy (Broadly Consistent)	
<p>The NBRB should move to a fully flexible exchange rate and anchor monetary policy on base money. In line with MCM TA, implement a wide band to help guide (strictly limited) interventions.</p>	<p>The NBRB shifted to a more flexible exchange rate and money aggregate targeting. The NBRB's 2016 Monetary Policy Guidelines state the de jure policy is a flexible exchange rate, with interventions limited to smoothing the volatility of the tracking currency basket. Exchange rates are market-set by continuous two-way auctions. The growth target for average broad money supply is set in the 2016 Monetary Policy Guidelines. The NBRB uses rubel base money as the operational target and broad money as the intermediate target. The system of policy instruments has been gradually strengthened since early 2015. Weekly liquidity auctions were introduced, taking account the liquidity</p>

¹ Prepared by Mariya Sviderskaya.

IMF 2015 Article IV Recommendations	Authorities' Responses
	forecast for the banking system. Standing facilities (overnight swap transactions) were reinstated. Reserve requirements were unified.
Financial Sector (Broadly Consistent)	
Conduct diagnostic studies of banks to assess asset quality and address problems.	The authorities have launched independent diagnostic studies ("AQRs") of banks and have committed to address deficiencies.
Ensure proper supervision and regulation of the DB.	Proposed legislation and implementing regulations name the NBRB as the supervisory authority for the DB. Final approval by the Presidential Administration is pending.
The NBRB should swiftly divest Moscow-Minsk Bank.	The NBRB is working with the EBRD towards divesting the Moscow-Minsk Bank, with a target date of end-2017.
Structural (Mixed)	
Liberalize prices; prepare a detailed plan to bring utility tariffs rapidly to full cost recovery.	In early 2016, prices for socially important goods were liberalized. Utility tariffs were increased in January 2016. The authorities say they will maintain a cost recovery rate of 58% in 2016. They aim for 75 percent cost recovery in 2017 and 100% in 2018 through a mix of tariff increases and cost reduction.
Mandatory production targets for enterprises should be phased out.	In December 2015, de jure production targets for SOEs were replaced with key efficiency indicators such as profitability, net profit, exports, and reduction of costs and inventories. However, some SOEs reported they continue to receive instructions regarding production levels.
Credible plans for large-scale privatization in the corporate and banking sectors should be prepared.	No plans for large-scale privatization have been presented. However, the authorities are working on criteria to help decide which SOEs would not be subject to privatization and which SOEs should prepare for future privatization or insolvency. Retenders will be held for several enterprises under the NIPA pilot privatization project. The authorities will finalize and announce a new SOE reform and restructuring strategy in 4Q2016.
Social safety nets, including unemployment insurance, should be strengthened to protect the vulnerable.	The authorities are planning to introduce non-cash subsidies for utilities payments from October 2016. The authorities are planning to increase unemployment benefits, but have not yet finalized the details.

Annex II. Public and External Sector DSAs (Baseline Scenario)

Public debt sustainability risks have increased substantially, mainly reflecting potential further depreciation and contingent liabilities risks related to bank and SOE recapitalization. Much of public debt is in foreign currency, making it vulnerable to exchange rate depreciation. The recessionary environment also poses significant challenges to meeting large gross financing needs. Under the baseline scenario, public debt is projected to peak at just under 70 percent of GDP in 2021. Gross financing needs are forecast to remain elevated over the medium term, at above 15 percent of GDP. External debt is at elevated levels. It is projected to peak at 83 percent of GDP in 2017, and then to very gradually fall (including under shock scenarios).

A. Background

1. Public Sector Debt coverage. Belarus's gross debt statistics cover the general government¹ and government guarantees. At end-2015, gross public and publicly guaranteed (PPG) debt amounted to 53.7 percent of GDP. Although the government has a large stock of assets, including around 12 percent of deposits in the banking sector (the NBRB and commercial banks), a portion of these deposits are in locked dollar deposits at the NBRB to offset FX reserves and directed lending, and might not be sufficiently liquid. Therefore, this Debt Sustainability Analysis (DSA) focuses on gross debt.² Should some deposits be freed up in the context of reductions in directed lending, there would be upside risks to this assessment.

2. Exchange rate depreciation poses large fiscal risks and is the main factor contributing to the deterioration of public debt ratios. The share of FX-denominated debt increased rapidly from 69 percent of total debt in 2014 to 86 percent in 2015, mainly as a result of sharp depreciation in 2015. At end-2015, resident holdings of FX-denominated debt were around 30 percent of total FX-denominated debt, or 14 percent of GDP.

Public and Publicly Guaranteed Debt, 2012-2015				
	2012	2013	2014	2015
(percent of GDP)				
PPG debt	32.0	34.5	37.3	53.7
Public debt	20.5	22.2	24.8	39.2
Local currency (held by residents)	4.1	3.4	3.4	3.1
FX	16.4	18.8	21.4	36.1
Domestic (held by residents)	2.3	3.4	4.2	9.5
External (held by non-residents)	14.1	15.5	17.2	26.6
Public guarantees	11.6	12.2	12.5	14.5
Local currency (held by residents)	8.7	7.9	8.1	4.4
FX	2.9	4.4	4.4	10.1
Domestic (held by residents)	0.3	1.3	0.9	4.3
External (held by non-residents)	2.6	3.1	3.5	5.8

Source: MoF.

3. Contingent liabilities are another major factor for the worsening debt dynamics. Estimated realized liabilities reflect the government's extensive involvement in economic activities, in the form of direct activity, SOEs, guarantees, and directed lending. The deterioration of the macroeconomic environment has put pressure on companies, including SOEs. Profit margins are

¹ Including local governments, social protection fund, and nuclear power plant spending.

² The government definition of debt includes only central government debt, which was around 37.8 percent of GDP at end of 2015

down and many enterprises are loss-making. As a result: (a) bank loans have become increasingly non-performing; (b) a high ratio of public guarantees has been called; and (c) in some cases, government has had to directly recapitalize SOEs. The baseline scenario assumes additional realization of contingent liabilities of around 15½ percent of GDP over 2016–2021. There is an additional need to recapitalize the NBRB (around 3 percent of GDP).

B. Baseline

4. Macroeconomic assumptions. The assumptions underpinning the public sector DSA are those of the baseline scenario. The recession that started in 2015 is projected to continue in 2016 and 2017 with a cumulative decline of around -7½ percent of GDP due to slowdown both from external and domestic demand. Growth is projected to recover in 2018 and then to converge to its potential growth rate of just over 1¾ percent of GDP in 2021. The assumed fiscal adjustment brings the primary balance to 1.8 percent of GDP by 2021, which implies an improvement of 2.8 percentage points of GDP during 2018–2021, partly reflecting completion of the nuclear power plant project. Projected nominal interest rates on new borrowing are between 6 and 10 percent over 2016–21, with the effective nominal interest rate at 6½ percent on average.³ In the baseline scenario, gross debt remains elevated, approaching 70 percent in 2021. Gross financing needs are projected to remain above the high-risk threshold of 15 percent of GDP on average over the medium term. By the end of the projection horizon, the primary balance required to stabilize debt in the baseline scenario is 1.8 percent of GDP.

5. Past forecast errors. Forecast errors in growth have been mixed, while there is a tendency of being pessimistic in primary balance forecasts in the past. The median forecast error for GDP growth and the primary balance were at -1.1 and 1.4 percent, respectively, while inflation forecast error is more in line with other countries' forecast errors (except the 2011–13 period).

6. Realism of projections. Belarus's projected fiscal adjustment (an improvement of about 2 percentage points in the cyclically adjusted primary balance/GDP over the medium term) is in line with other countries' experiences, with a 3-year cyclically adjusted primary balance at the 27th percentile among all surveillance countries.

C. Public Sector DSA: Shocks and stress tests

7. Stress tests indicate that debt dynamics in Belarus are particularly vulnerable to changes in the exchange rate.

- **Real GDP Growth Shock.** The impact on the debt-to-GDP ratio of the 1 standard deviation shock (4.8 percent) to real GDP growth is large. Real GDP growth rates become negative over 2017–18 with around 100 bps lower inflation each year. The primary balance worsens before recovering in 2019; interest rates increase accordingly and remain high until 2021. In this

³ Interest rate calculation excludes guarantees.

scenario, gross debt increases above 90 percent of GDP in 2021 while gross financing needs reach almost 30 percent of GDP.

- **Real exchange rate shock.** The impact on the debt-to-GDP ratio of shock to exchange rate (178 percent depreciation; the maximum achieved in the past decade) could result in an increase of gross debt to 110 percent of GDP, while gross financing needs would reach 39 percent of GDP. This vulnerability is the result of rising debt dollarization. Foreign investors hold a negligible portion of domestic government debt.
- **Real interest rate and primary balance shocks.** These two shocks introduce interest rate hikes starting from 2017, and a deteriorating primary balance in 2017–2018, in comparison with the baseline. However, these two shocks do not change debt dynamics significantly.
- **Combined macro-fiscal shock.** An additional combined macro-shock scenario pushes the debt-to-GDP ratios to above 200 percent, with the largest contribution to the shock stemming from the exchange rate. The macro-fiscal shock combines the growth and interest rate shocks and a primary balance shock as in the standard examples in the stress tests, together with the real exchange rate shock consistent with a maximum movement of the real exchange rate over the past 10 years and a pass-through coefficient of 0.25. The effect of these shocks on debt ratios and gross financing needs is large and reflects in particular the sensitivity of debt to exchange rate shocks, which make the largest contribution to the change in the debt path.

Risk	Relative Likelihood and Transmission Channels	Expected Impact of Risk	Policy Recommendations
1. Persistently lower energy prices or disruptions in energy price arrangements with Russia	<p style="text-align: center;">High</p> <ul style="list-style-type: none"> Reduced export revenues of refined oil products from lower world prices or reduced margins on energy export and import prices. Spillover effects from Russia through trade and financial channels. 	<p style="text-align: center;">High</p> <ul style="list-style-type: none"> Renewed BOP pressures and potential BYR depreciation. Confidence could be undermined, adversely affecting FX liquidity and increasing banks' FX liquidity risks (particularly given high dollarization). 	<ul style="list-style-type: none"> A more flexible exchange rate remains key to cushion the shock (limit interventions to dampening excessive volatility). Advance structural reforms to improve economic efficiency and enhance economic diversification. Use fiscal policy to help counter BOP pressures.
2. Tighter or more volatile global financial conditions	<p style="text-align: center;">Medium</p> <ul style="list-style-type: none"> Sharp asset price adjustment and decompression of credit spreads as investors reassess underlying risk and respond to unanticipated changes in growth and financial fundamentals in large economies, the Fed policy rate path, and increases in U.S. term premia. This could undermine Belarus's access to capital markets. 	<p style="text-align: center;">Medium</p> <ul style="list-style-type: none"> Investors could reassess risks of holding Belarusian assets, undermining market access and resulting in abrupt external adjustment through depreciation. Russian banks could come under pressure, forcing accelerated deleveraging in Belarus. Confidence in the domestic financial sector could be weakened, increasing banks' credit and FX liquidity risks. NPLs could increase further, threatening solvency of the banking system. 	<ul style="list-style-type: none"> A more flexible exchange rate remains key to cushion the shock (limit interventions to dampening excessive volatility). Tighten monetary policy if needed for financial stability. The NBRB could provide liquidity support to solvent banks. Fiscal policy should remain conservative to counter BOP pressures.
3. Sharper-than-expected global growth slowdown	<p style="text-align: center;">Low/Medium</p> <ul style="list-style-type: none"> Slowdown in China could result in weak domestic demand, suppresses commodity prices, roil global financial markets, and reduce global growth. <p style="text-align: center;">High /Medium</p> <ul style="list-style-type: none"> Structurally weak growth in key advanced and emerging economies, especially Russia, could undermine medium-term growth in emerging markets as easy global financial conditions come to an end alongside insufficient reform progress. 	<p style="text-align: center;">Medium</p> <ul style="list-style-type: none"> Financial volatility raises risk aversion, causing re-pricing of Belarus's risks. <p style="text-align: center;">Medium</p> <ul style="list-style-type: none"> Significant dependency on trade with and financing from Russia could open significant financing gaps and undermine growth in Belarus. 	<ul style="list-style-type: none"> More flexible exchange rate remains key to cushion the shock (limit interventions to dampening excessive volatility). Structural reforms should be advanced to improve economic efficiency and enhance economic diversification.
4. Larger-than-expected liabilities from quasi-fiscal activities	<p style="text-align: center;">High</p> <ul style="list-style-type: none"> Estimated liabilities in the SOE sector are highly uncertain, and could be larger (or smaller) than preliminary estimates 	<p style="text-align: center;">High</p> <ul style="list-style-type: none"> Losses could translate into higher public debt, including from direct state bailouts of strategic SOEs, or indirectly through recaps of state-owned banks with SOE-related losses. 	<ul style="list-style-type: none"> Further fiscal adjustment to achieve debt targets. Pursue faster and broader structural reforms in the SOE sector to improve monitoring (e.g., for SOE fiscal risk assessment), governance, and performance.
5. Uneven domestic policy implementation	<p style="text-align: center;">Medium</p> <ul style="list-style-type: none"> Political consensus could break down (accelerate) over the direction, depth, and pace of reforms. 	<p style="text-align: center;">High</p> <ul style="list-style-type: none"> This would increase (decrease) vulnerabilities and crisis risks, and lower (raise) growth prospects. 	<ul style="list-style-type: none"> In the slowdown scenario, alternative measures could be needed to mitigate crisis risks.

^{1/} The RAM shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Annex IV. Measures Affecting Interest Rates and FX Demand

1. **Nominal and real interest rates have been at elevated levels for a sustained period.**

(Annex IV). Following the foreign exchange crisis and a surge in inflation in early 2011, the authorities implemented a number of measures to stabilize the economy. These have included tighter monetary and fiscal policies and a shift to a more flexible exchange rate regime. While the inflation rate stabilized by mid-2013, monetary policy has been kept tighter in light of the devaluation in early 2015. Real rates have remained significantly above the average prior to the crisis: real lending rates for new loans in local currency (excluding concessional lending) have averaged 20 percent for legal entities and 18.3 percent for HHs since 2013, compared to 5.3 percent and 7.8 percent in Jan-2005-Mar-2011, respectively. Real interest rates for new term-deposits in local currency averaged 11.0 percent for legal entities and 17.0 percent for HHs since 2013, compared to 1.1 percent and 4.6 percent during the earlier period. Possible factors contributing to the higher real rates in local currency are elevated inflation expectations including from depreciation risks and weak policy credibility, and a weak monetary policy transmission mechanism.

2. **The monetary transmission mechanism has been constrained by high dollarization and government directed lending.**

Foreign currency lending accounts for 38 percent of total credit to the economy, and directed lending (in both local and foreign currencies) accounts for about 35 percent as of mid-2016. The share of non-directed lending in local currency declined to 18 percent compared to a peak of over 40 percent in early 2011, in part reflecting the significant depreciation of the BYR. The interest rates for non-concessional loans have been driven up given diversion of lending resources to government programs. On the funding side, interest rates on new fixed-term deposits have gone through repeated cycles of surge and decline in recent years, reflecting volatile exchange rate expectations.

3. **Beginning in 2015, the NBRB has implemented increasingly tighter recommendations and administrative measures to create incentives to lower lending and deposit rates.**⁹ These measures rely on penalties for non-compliance, with a prudential element mixed in. These measures have been only partially binding so far, and real interest rates remain significantly positive (Annex IV).

- *Lending rates.* The NBRB has set lending rate thresholds that, if exceeded, trigger special provisioning. For lending rates, the coefficients are set at 1.4 and 1 for HHs and legal entities. The authorities say the measures are in part intended to mitigate incentives for high interest loans to failing borrowers—and are coordinated with steps to free up credit space for non-concessional borrowers by reducing directed lending.
- *Deposit rates.* The NBRB has also issued recommended limits on deposit rates that, if exceeded, trigger higher required reserves. As of June 2016, the thresholds for fixed-term deposits in local

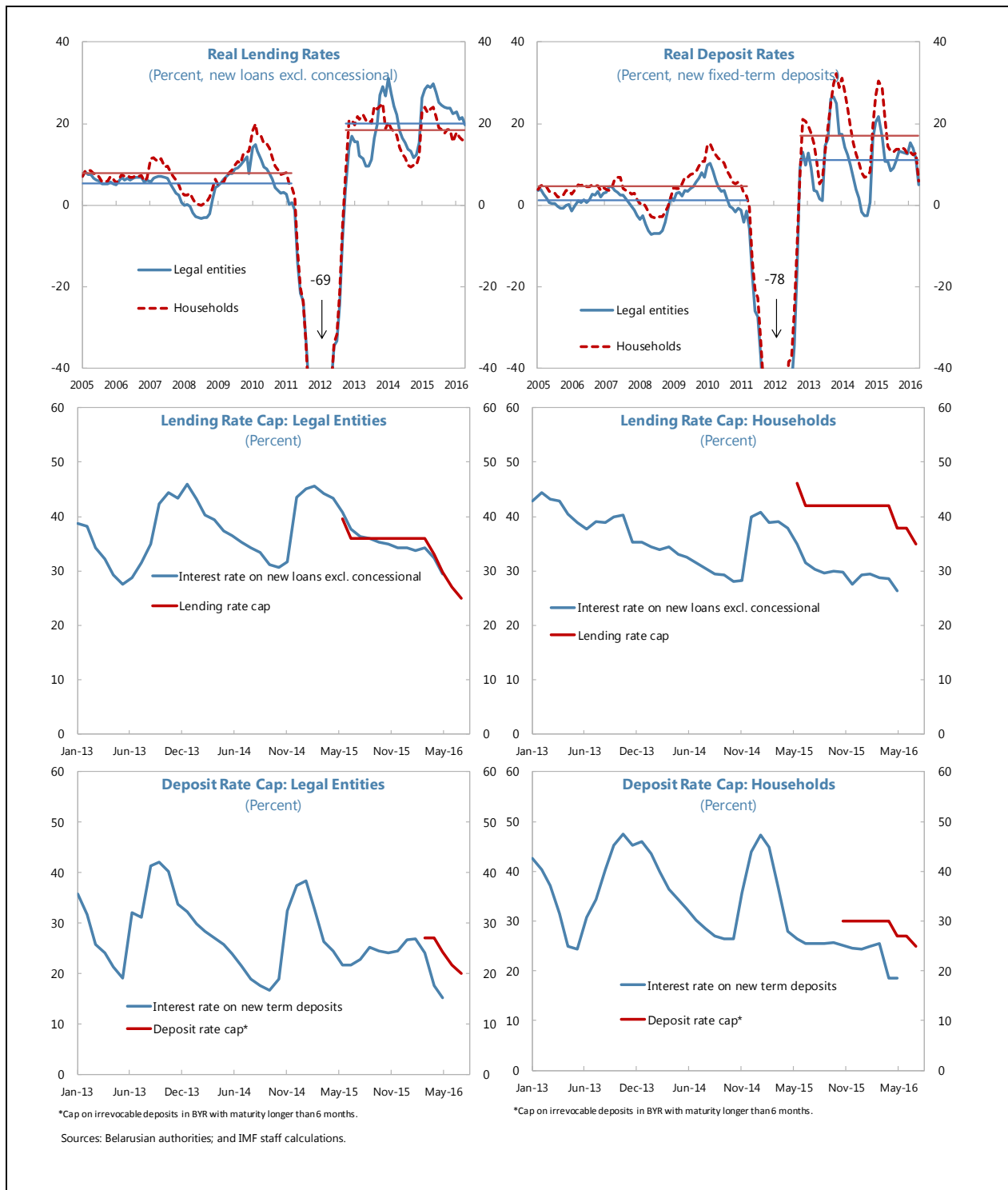
currency are set at 1 and 0.8 times the NBRB's overnight credit rate for irrevocable and revocable deposits over 6 months for HHs,¹ and 0.8 and 0.6 respectively for legal entities. According to the

- authorities, they also create prudential incentives for attracting more stable time deposits by allowing higher limits for longer term deposits.

4. Administrative measures affecting FX demand. Corporate purchases of foreign currencies can be made for limited purposes only, including for FX debt payments and imports. Corporates also have a mandatory surrender requirement of 30 percent of corporate FX proceeds. The mandatory surrender rate was temporarily increased to 50 percent in December 2014 in light of exchange rate pressures, and was reduced to 40 percent in February 2015 and back to 30 percent in April 2015 (following the shift to a more flexible exchange rate).

¹The coefficient for irrevocable household deposits over six months will be reduced to 0.9 from August 2016.

Annex IV. Measures Affecting Interest Rates



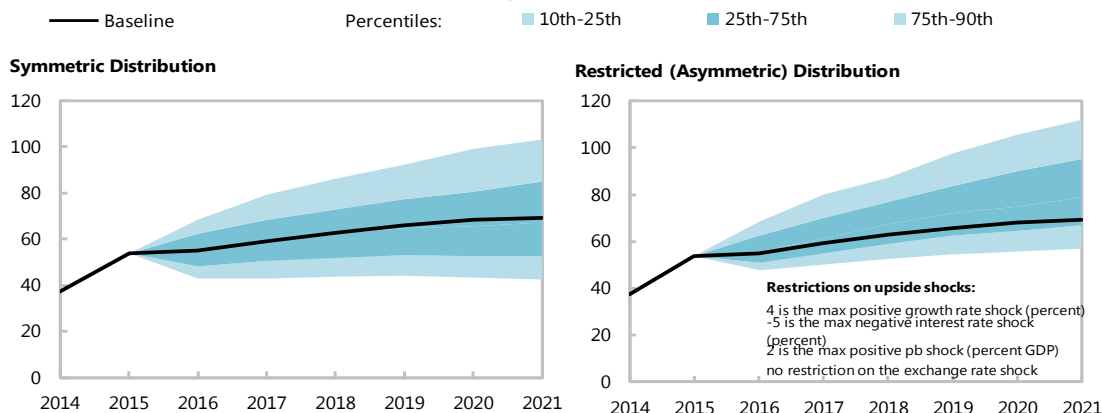
Belarus Public DSA Risk Assessment

Heat Map

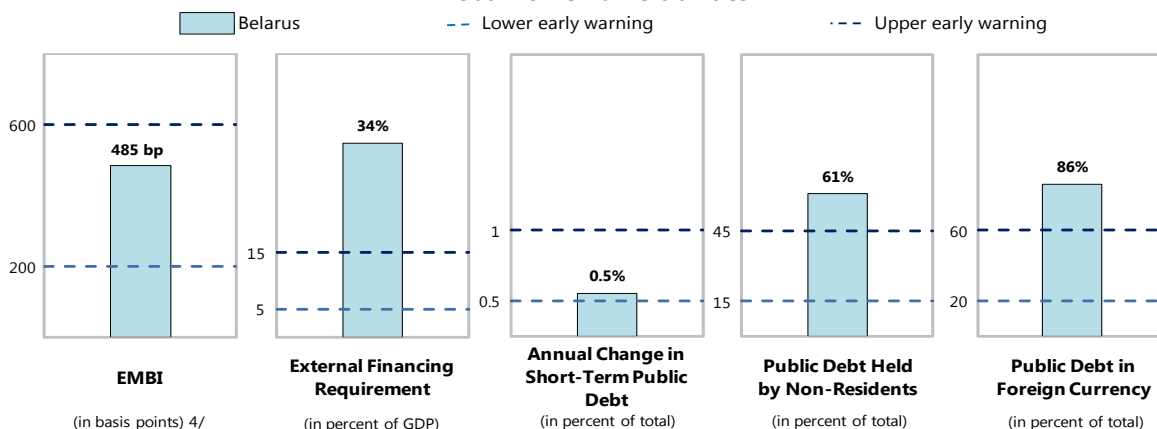
Debt level ^{1/}	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock ^{5/}
Gross financing needs ^{2/}	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile ^{3/}	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ An average over the last 3 months, 13-Apr-16 through 12-Jul-16.

5/ The baseline scenario already incorporates the expected fiscal costs of the materialization of contingent liability. Therefore, stress test of contingent liability is not applicable to Belarus, as expected fiscal costs have been already added into the debt concept in DSA.

Belarus Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus all countries

Real GDP Growth

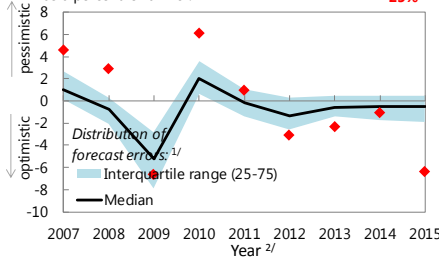
(in percent, actual-projection)

Belarus median forecast error, 2007-2015:

-1.06

Has a percentile rank of:

25%



Primary Balance

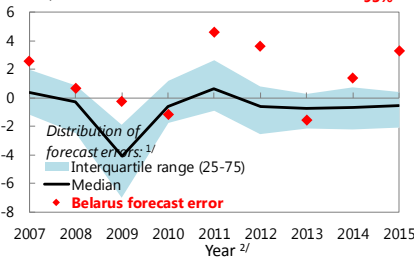
(in percent of GDP, actual-projection)

Belarus median forecast error, 2007-2015:

1.42

Has a percentile rank of:

93%



Inflation (Deflator)

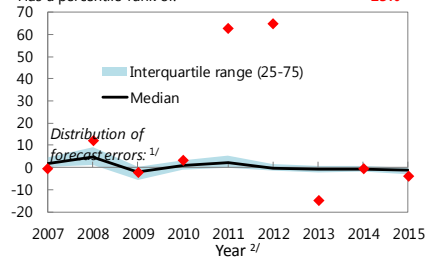
(in percent, actual-projection)

Belarus median forecast error, 2007-2015:

-0.57

Has a percentile rank of:

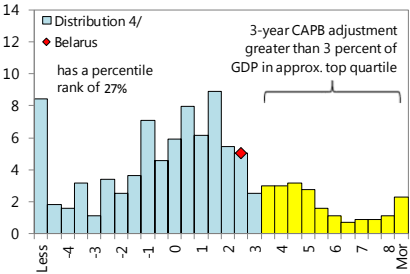
25%



Assessing the Realism of Projected Fiscal Adjustment

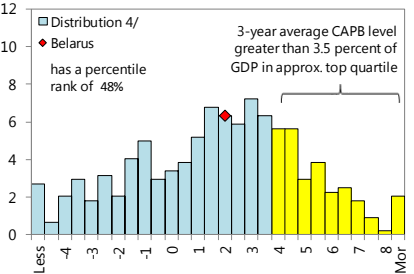
3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)

(Percent of GDP)



3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)

(Percent of GDP)

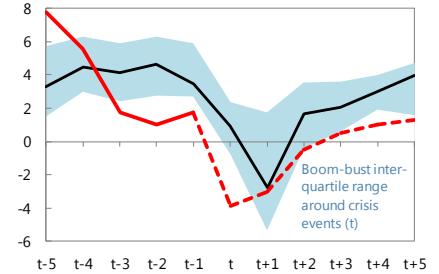


Boom-Bust Analysis^{3/}

Real GDP growth

(in percent)

— Belarus



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Belarus has had a positive output gap for 3 consecutive years, 2013-2015. For Belarus, t corresponds to 2016; for the distribution, t corresponds to the first year of the crisis..

4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Appendix I. Public Sector Debt Sustainability Analysis (DSA) Baseline Scenario

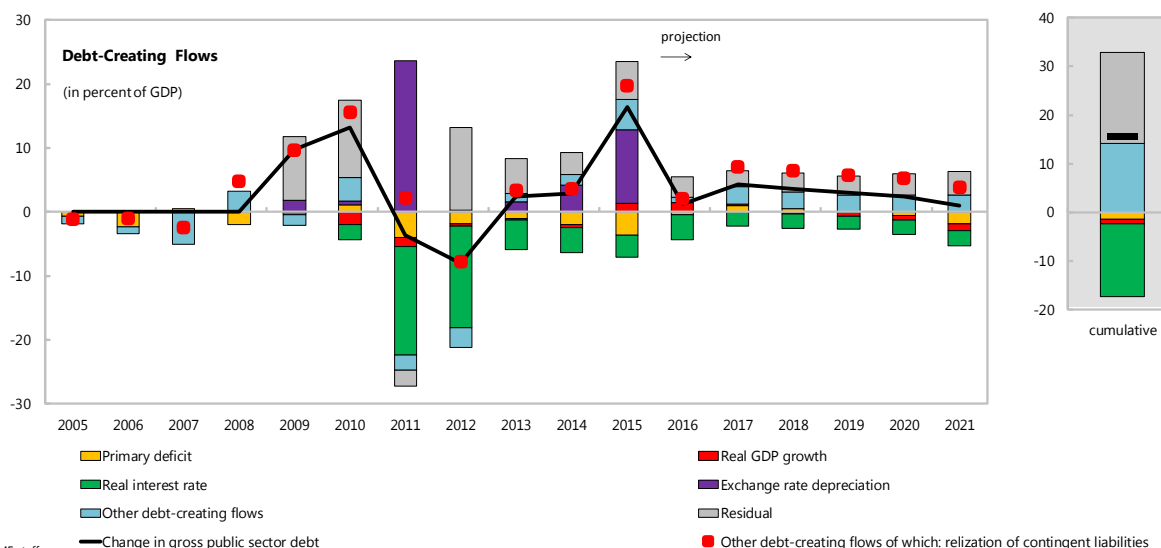
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of July 12, 2016		
	2005-2013 ^{2/}	2014	2015	2016	2017	2018	2019	2020	2021	Sovereign Spreads		
Nominal gross public debt and guaranteed debt	25.1	37.3	53.7	54.9	59.1	62.7	65.7	68.2	69.3	EMBI (bp) ^{3/}		451
Public gross financing needs	2.7	7.8	5.7	8.3	14.5	15.9	16.8	19.7	20.9	CDS (bp)		n.a.
Memorandum Items												
Real GDP growth (in percent)	6.1	1.7	-3.9	-3.0	-0.5	0.5	1.0	1.3	1.8	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	27.6	17.8	16.3	13.0	8.7	8.9	8.3	8.6	8.7	Moody's	Caa1	n.a.
Nominal GDP growth (in percent)	35.0	19.9	11.8	9.6	8.2	9.5	9.4	10.0	10.7	S&P's	B-	n.a.
Effective nominal interest rate (in percent) ^{4/}	6.8	6.8	7.8	6.4	6.3	6.4	6.5	6.5	6.4	Fitch	B-	n.a.
Effective real interest rate (in percent)	-20.8	-11.0	-8.5	-6.6	-2.4	-2.6	-1.8	-2.1	-2.3			

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021		
Change in gross public sector debt	2.7	2.9	16.4	1.2	4.2	3.6	3.0	2.5	1.1	15.6	
Identified debt-creating flows	-4.9	-0.6	10.5	-2.1	1.7	0.6	0.1	-0.8	-2.6	-3.1	
Primary deficit	-1.2	-2.0	-3.6	-0.4	1.0	0.5	-0.1	-0.5	-1.8	-1.3	1.8
Primary (noninterest) revenue and grants	43.0	38.4	40.7	37.5	37.7	37.8	37.9	38.1	38.3	227.3	
Primary (noninterest) expenditure	41.8	36.5	37.1	37.1	38.7	38.3	37.8	37.6	36.5	226.0	
Automatic debt dynamics ^{5/}	-3.2	-0.3	9.3	-2.4	-2.0	-2.5	-2.5	-3.0	-3.5	-15.9	
Interest rate/growth differential ^{6/}	-8.8	-4.4	-2.2	-2.4	-2.0	-2.5	-2.5	-3.0	-3.5	-15.9	
Of which: real interest rate	-8.0	-4.0	-3.5	-3.9	-2.2	-2.3	-1.9	-2.2	-2.4	-14.9	
Of which: real GDP growth	-0.8	-0.5	1.3	1.5	0.3	-0.3	-0.6	-0.8	-1.1	-1.0	
Exchange rate depreciation ^{7/}	5.6	4.2	11.5	...	...	...	...	...	...	...
Other identified debt-creating flows	-0.7	1.6	4.8	0.8	2.7	2.7	2.7	2.7	2.7	14.2	
General Government: Net Privatization Proceeds (negative)	-1.7	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.2	
Realized contingent liabilities	1.1	0.7	3.4	1.0	2.9	2.9	2.9	2.9	2.9	15.4	
Guaranteed debt	-0.1	0.3	2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes ^{8/}	7.6	3.4	5.9	3.3	2.5	2.9	2.9	3.3	3.7	18.6	



Source: IMF staff.

1/ Public sector is defined as the augmented general government (including local government, Social Protection Fund, nuclear power plant spending) and guarantees.

2/ Based on available data.

3/ EMBL

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - p(1+g) - g + ae(1+r))/(1+g+p+gp)]$ times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate;

a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

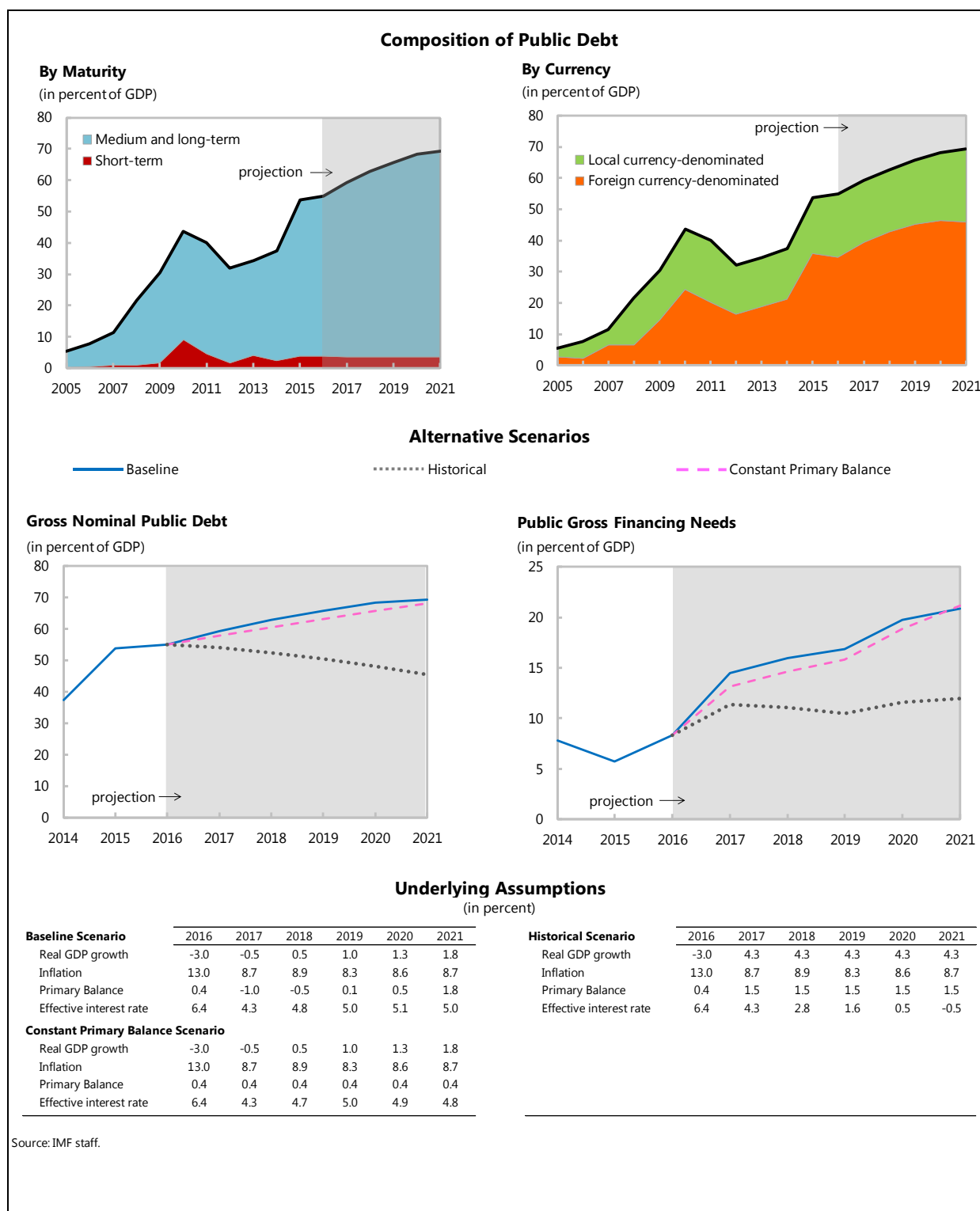
6/ The real interest rate contribution is derived from the denominator in footnote 4 as $r - p(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 2/ as $ae(1+r)$.

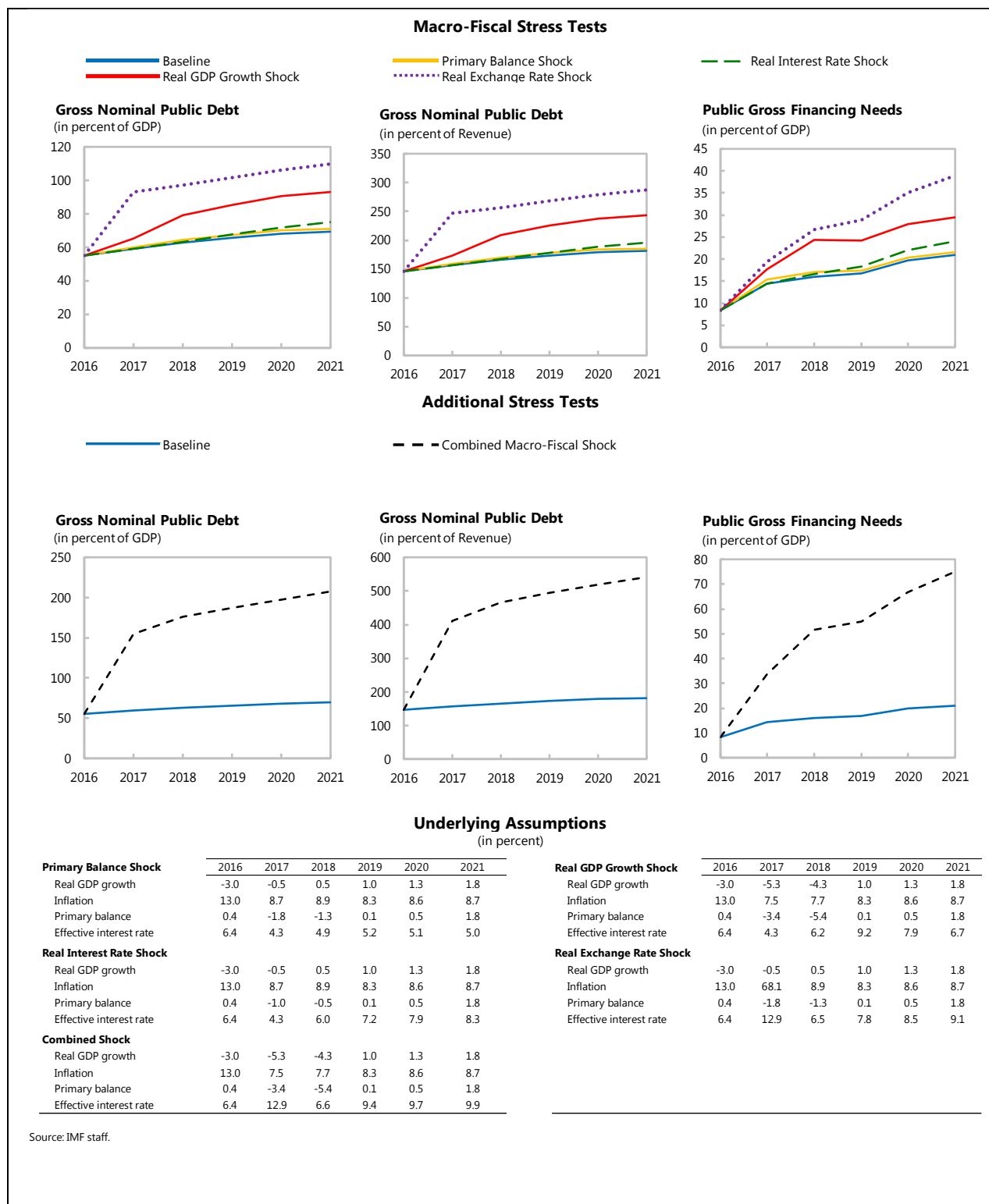
8/ For projections, this line includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Appendix II. Public DSA—Composition of Public Debt and Alternative Scenarios



Appendix III. Public DSA–Stress Tests



(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -3.5
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	
Baseline: External debt	57.0	53.1	54.2	52.6	70.1	81.8	82.7	81.4	80.1	77.8	74.0	
Change in external debt	5.5	-3.9	1.1	-1.6	17.5	11.7	1.0	-1.4	-1.3	-2.2	-3.9	
Identified external debt-creating flows (4+8+9)	-1.5	-2.3	1.4	2.8	22.1	4.6	2.7	1.5	0.8	0.0	-1.5	
Current account deficit, excluding interest payments	7.0	1.2	8.7	5.2	1.1	2.4	2.0	1.5	0.9	0.3	0.1	
Deficit in balance of goods and services	2.0	-4.5	3.2	0.6	-0.3	2.1	1.3	1.1	0.8	0.2	0.1	
Exports	77.9	81.6	60.3	56.9	60.1	60.9	63.2	62.5	62.2	61.5	60.9	
Imports	79.9	77.1	63.5	57.5	59.8	62.9	64.5	63.6	62.9	61.7	61.0	
Net non-debt creating capital inflows (negative)	-6.1	-1.7	-2.1	-1.9	-2.4	-2.7	-2.6	-2.5	-2.6	-2.7	-3.5	
Automatic debt dynamics 1/	-2.5	-1.7	-5.3	-0.5	23.4	4.9	3.2	2.5	2.5	2.4	1.9	
Contribution from nominal interest rate	1.4	1.8	1.6	1.6	2.7	2.5	2.9	2.9	3.3	3.4	3.3	
Contribution from real GDP growth	-2.6	-0.9	-0.5	-0.9	2.8	2.4	0.4	-0.4	-0.8	-1.0	-1.3	
Contribution from price and exchange rate changes 2/	-1.3	-2.5	-6.4	-1.2	17.9	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	7.1	-1.6	-0.3	-4.4	-4.6	7.1	-1.7	-2.9	-2.2	-2.2	-2.4	
External debt-to-exports ratio (in percent)	73.1	65.1	90.0	92.4	116.5	134.3	131.0	130.1	128.8	126.6	121.5	
Gross external financing need (in billions of US dollars) 4/	18.9	18.4	23.7	26.4	20.2	18.3	18.1	18.2	18.2	18.2	18.2	
in percent of GDP	31.6	29.0	32.4	34.6	37.1	37.9	36.6	35.4	34.0	32.6	31.0	
Scenario with key variables at their historical averages 5/						81.8	83.6	84.2	85.1	86.0	86.4	-5.9
Key Macroeconomic Assumptions Underlying Baseline						<u>10-Year Historical Average</u>	<u>10-Year Standard Deviation</u>					
Real GDP growth (in percent)	5.5	1.7	1.0	1.7	-3.9	4.3	4.8	-3.0	-0.5	0.5	1.0	1.8
GDP deflator in US dollars (change in percent)	2.5	4.7	13.8	2.3	-25.3	2.9	14.6	-9.1	3.4	3.5	2.9	2.7
Nominal external interest rate (in percent)	3.0	3.3	3.5	3.2	3.7	3.4	0.5	3.2	3.6	3.7	4.2	4.4
Growth of exports (US dollar terms, in percent)	55.6	11.5	-15.1	-1.7	-24.2	9.4	27.7	-10.8	6.8	3.0	3.4	3.5
Growth of imports (US dollar terms, in percent)	27.8	2.7	-5.4	-5.6	-25.4	8.8	24.1	-7.3	5.4	2.7	2.8	3.3
Current account balance, excluding interest payments	-7.0	-1.2	-8.7	-5.2	-1.1	-6.6	4.1	-2.4	-2.0	-1.5	-0.9	-0.1
Net non-debt creating capital inflows	6.1	1.7	2.1	1.9	2.4	2.8	1.4	2.7	2.6	2.5	2.6	3.5

1/ Derived as $[r - g - r(1+g) + ea(1+r)] / (1+g+rr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,

e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+rr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

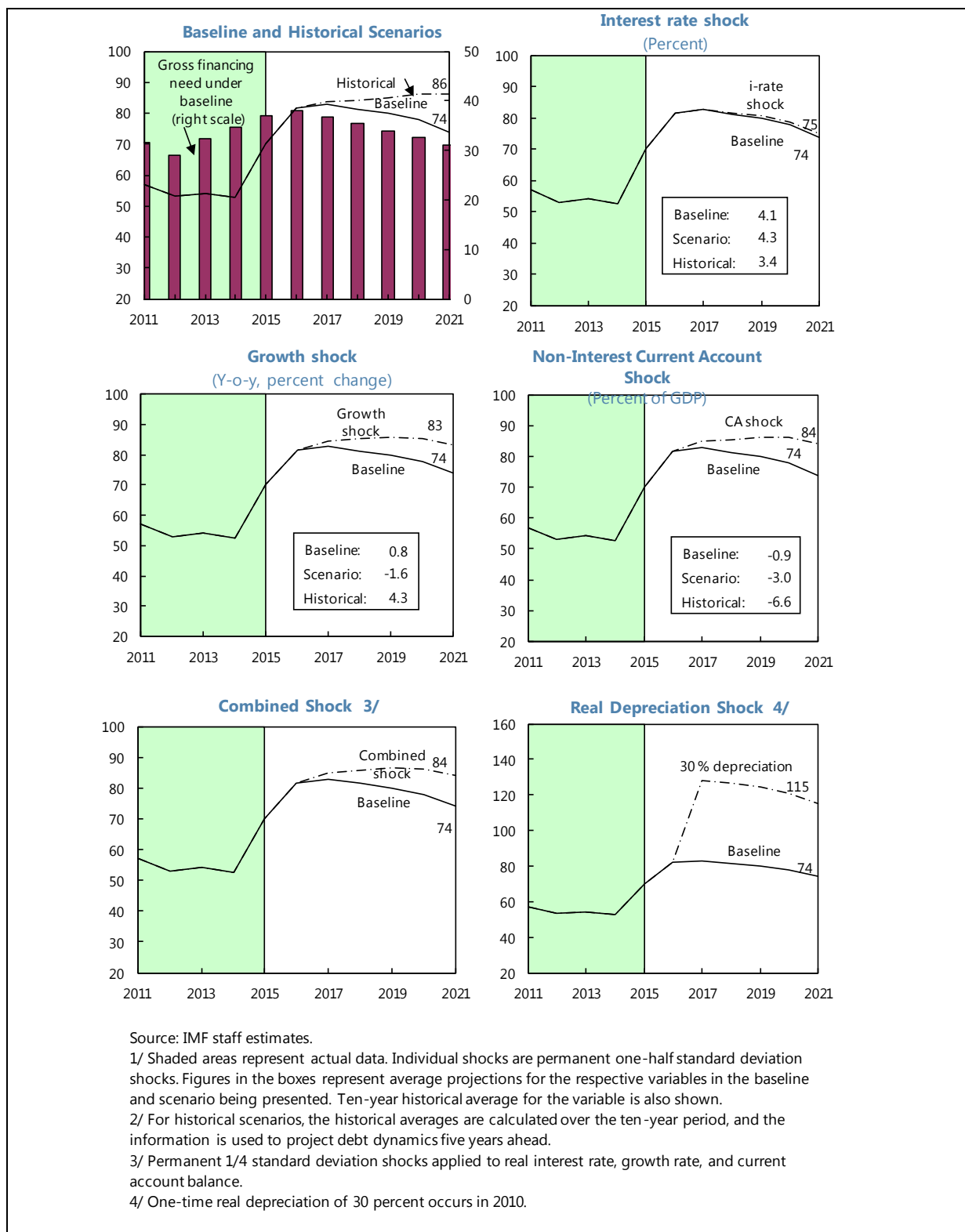
3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Appendix V. External Debt Sustainability: Bound Tests 1/ 2/ (External debt in percent of GDP)



Statement by the Staff Representative on Belarus
September 2, 2016

- 1. This statement provides information that has become available since the issuance of the Staff Report on August 11, 2016.** This information does not alter the thrust of the staff appraisal.
- 2. Effective August 17, 2016, the National Bank of the Republic of Belarus (NBRB) lowered the refinancing rate and rates on liquidity provision instruments.** The refinancing rate was reduced from 20 to 18 percent and interest rates on standing facilities and bilateral operations of the NBRB were reduced from 25 to 23 percent. The Board of the NBRB noted slowing inflation, net supply of foreign exchange on the domestic foreign exchange market, an improvement in deposit structure towards irrevocable deposits with longer maturities, and other factors. They noted that lower interest rates will also help reduce financial stability risks by improving the ability of non-financial organizations to fulfill credit obligations to banks.
- 3. The non-performing loans continue to increase.** At the end of July 2016 the share of NPLs in gross loans reached 14.3 percent relative to 13.4 percent at the end of June 2016 and 6.8 percent at the end of 2015.
- 4. An independent asset quality review of nine banks has been completed.** The results are expected to be discussed by the Financial Stability Council.
- 5. Effective August 5, 2016 the NBRB became the supervisor of the Development Bank.**

**Statement by Mr. Canakci, Executive Director for the Republic of Belarus
and Mr. Misyukovets, Advisor to Executive Director
September 2, 2016**

The Belarusian authorities appreciate the productive dialogue with the Fund staff during the 2016 Article IV Consultation. Since they agree with the staff's assessment of macroeconomic developments and their recommendations on economic and financial policies, we will elaborate on the recent developments, the authorities' policy response to challenges, and the prospects for cooperation with the Fund.

Recent Macroeconomic Developments and Outlook

In 2015-2016, Belarus has been facing strong combined exogenous shocks, with adverse global and regional events continuing to dampen economic activity in Belarus. In 2015, for the first time in two decades, real GDP contracted by 3.9 percent. Ample supplies and weak demand, especially for industrial commodities, contributed to the continued slide in most commodity prices in 2015 globally and had a direct adverse impact on Belarus' exports. The sharp decline in oil prices in the second half of 2014 triggered a recession in Russia, Belarus' main trading partner, and contracted demand for manufactured goods, including trucks, agricultural machinery, tractors and metal products. During 2015, exports of goods to Russia fell by 31.5 percent year-on-year in dollar terms. The economic crisis and the conflict in Ukraine, the second largest trading partner for Belarus, resulted in a 38 percent drop in exports, while Ukraine's share in Belarus' total merchandise trade continued to shrink. Overall, exports and imports of goods and services declined drastically in dollar values, by 24.2 percent and 25.4 percent, respectively, although the trade balance in 2015 was moderately positive at 0.3 percent of GDP.

The efforts to address inflationary pressures by containing liquidity, credit and wage growth helped keep inflation contained, but it remained in double digits and reached the projected 12 percent in 2015, fueled by the need to increase regulated utility and public transport tariffs, fiscal revenue enhancing measures, and rubel depreciation. After a spike in early 2016, inflation had been decelerating steadily since March and, for January-July 2016, it reached 7.8 percent, with the resulting annualized inflation of 12.4 percent nearing the authorities' 2016 target of 12 percent.

Fiscal policy continued to be prudent despite persistent pressures from lower-than-projected growth rates, declining external trade, and deteriorating financial performance in the real sector. Nevertheless, the general and central government budgets in 2015 reported a surplus of 1.5 percent and 1.7 percent of GDP, respectively, as a result of stringent fiscal policy measures. Adverse developments continue to strongly impact fiscal performance, but the authorities firmly aim at maintaining a budget surplus. As a result of robust fiscal consolidation, the general and central government budgets in January-June 2016 reported a surplus of 1.6 percent and 1.5 percent of GDP, respectively.

Owing to tighter macroeconomic policies, the current account deficit narrowed consistently from 10.4 percent of GDP in 2013 to 6.9 percent of GDP in 2014, and to 3.8 percent of GDP in

2015. In January-June 2016, the current account deficit amounted to \$1.5 billion, somewhat higher than in January-April 2015 (\$0.9 billion). The current account deficit for the entire year 2016 is estimated at up to 5 percent of GDP. Following the protracted global commodity price trend, exports of goods in January-June 2016 contracted by 18.8 percent and imports dropped by 13.0 percent compared to the same period a year earlier. Overall, the turnover of external trade in goods and services in January-June 2016 declined by 13.6 percent in dollar terms, with a slight deficit of trade in goods of \$148.7 billion, mainly due to the decline of export prices despite the 1.2 percent growth in export volume compared to the first six months of 2015. Excluding the trade in energy products and potash exports, the foreign trade balance improved by \$418 million, or 1.9 percent of GDP.

The economic outlook is subject to uncertainty. The recession has continued in 2016, driven by subdued oil prices, weak demand for Belarusian exports, and structural bottlenecks. In January-June 2016, GDP dropped by 2.7 percent compared to the same period in 2015, although month-on-month data shows signs of a bottoming out and a gradual slowdown of the decline, indicating an improvement towards year-end. Although a recovery into positive territory in 2016 is unlikely, real GDP may contract by about 2 percent in 2016 in the absence of further shocks. Despite some recovery of oil prices, public finances and external balances are under strain, while continued oil and commodity price volatility clouds the outlook. The level of international reserves remains low, enough to cover about 1.7 months of imports. The deteriorating terms of trade and subdued domestic demand put pressure on corporate finances, increasing the number of unprofitable operating enterprises. Non-performing loans rose to 14.25 percent of total lending at end July 2016, from 6.8 percent at end July 2015, mainly due to the recession and exchange rate depreciation. Real wages declined by 3.9 percent as compared to January-June 2015, suggesting a deterioration of household welfare. Unemployment increased to 1 percent in 2015 from 0.50 percent in 2014 and, as of July 1, 2016 stood at 1.1 percent.

Policy Response

Strengthening policy action is of critical importance. External uncertainties necessitate enhancing the flexibility of the economy to adjust to external shocks and ensuring the effective distribution of resources. The authorities are in the process of implementing a set of policies aimed at safeguarding and strengthening economic stability based on sound macroeconomic management to mitigate the impact of the economic downturn and at creating conditions for sustainable growth. As in 2015, the macroeconomic framework hinges on a tight monetary and fiscal stance, exchange rate flexibility, market-determined credit supply, and productivity-based wage dynamics. Restoring sustainable growth in the medium term will require broad-based structural reforms.

Fiscal policy has been instrumental in addressing shocks. Decisive revenue enhancing measures were taken for the 2016 budgeting through broadening the tax base, raising the rates for certain taxes, and eliminating tax concessions. However, the continued negative effect of macroeconomic conditions driven above all by external factors, such as the world oil price decline and the depreciation of the Russian ruble, necessitated further steps to be taken to collect additional revenues and reduce the dependence of revenues on external demand for raw materials. On the expenditure side, substantial debt service payments were incurred due to

significant external debt liabilities and the depreciation of the BYN. Nevertheless, the authorities' policy action, including at the regional level, have helped sustain fiscal performance and led to a general government budget surplus, even as the economy contracted. Overall, in the first six months of 2016, the authorities implemented strong fiscal consolidation measures in the total amount of BYN 2 billion, reserved and deferred spending for a total of BYN 1.6 billion, or 5.6 percent of expenditures. Mindful of the demographics and the need to maintain a fiscal balance of the pension system, the authorities launched a pension reform, with a gradual increase of the retirement age for men and women by three years during the next six years.

Monetary policy is firmly aimed at slowing down inflation. To achieve this objective, the authorities, in line with the Fund's recommendations, keep tight control over money supply and will limit broad money growth in 2016 to below 18 percent (December-on-December) against 41 percent in 2015. Policy rates remain positive in real terms. Deposit interest rates are kept positive, and lending activities are managed using standard market toolkits. In the context of price liberalization – including the prices of natural monopolies – inflation will stay in double digits in 2016, but the authorities are confident that monetary targeting will allow for bringing inflation down to single digits from 2017 and to 5 percent by 2020. In the medium term, the authorities plan to transition to inflation targeting.

A managed floating exchange rate regime is in place as a step toward a full float as the ultimate goal. Limited interventions of the National Bank in the foreign exchange market resulted in a net purchase in an effort to build up international reserves, while the rubel depreciated in 2015 by 36 percent against the basket of currencies. A notable depreciation of the real effective exchange rate of the rubel contributed to price competitiveness of the Belarusian merchandise. The achieved stability allows the authorities to lower surrender requirement for exporters from 30 percent to 20 percent from September 1, 2016, and to announce the further liberalization of the foreign exchange market. Coupled with measures to contain wage growth and fiscal consolidation, the new exchange rate regime triggered a rapid reversal of the market sentiment – in January-July 2016, net sale of foreign exchange by households amounted to \$886 million. Trade in foreign exchange by corporate market participants was balanced, with sales and purchases of \$8.9 billion each. As confidence rebounded markedly, the rubel depreciated moderately in 2016 and created conditions for a redenomination of the national currency unit.

Banking supervision is continuously strengthened. Keeping the share of problematic assets at an economically safe level will continue to be achieved through further limitation of credit and foreign exchange risks, including on the basis of comprehensive assessments of borrowers' financial positions. Nevertheless, the banking system has a certain capital resource: as of August 1, 2016, the actual regulatory capital adequacy ratio was at 17.1 percent, with the requirement of 10.625 percent accounting for the conservation buffer. Banking supervision pays increased attention to banks' corporate governance and risk management systems. In order to strengthen equity and liquidity management, Basel III capital requirements have been adopted this year, and work will continue to comply with Basel III liquidity requirements. In April 2016, a joint IMF/World Bank mission completed an appraisal for Belarus under the Financial Sector Assessment Program (FSAP). The FSAP team assessed progress in achieving compliance with international banking sector supervision standards and noted the accomplishments in establishing an integrated bank supervisory process. In line with staff's recommendation, an independent

asset quality review of the largest banks has been completed to inform practical steps to strengthen financial sustainability of the banking system.

Structural reforms are key to regaining competitiveness and diversifying the economy. The Roadmap for Structural Reforms, prepared jointly with the World Bank, supported the authorities' intention to safeguard achievements of macroeconomic stabilization and address structural constraints. To this end, a number of relevant policy measures have been implemented, such as the abolition of price controls over socially important goods and tightening of conditions for government directed lending and long-term financial assistance to state-owned enterprises (SOEs). In April 2016, the Government approved an Action Program for 2016-2020 geared toward regaining competitiveness, reducing vulnerability to developments in the external environment, and promoting economic growth in a sustainable manner.

Progress has been made with improving corporate governance of SOEs by replacing the system of hard quantitative targets with indicative ones and by setting profitability and efficiency as primary objectives for SOEs. Progress with the actual privatization of SOEs, however, has been limited, primarily reflecting low investors' demand, but the authorities are moving ahead with the sale of small- and medium-sized SOEs. In June 2016, an international competition was announced to attract investors for two of the eight companies under the pilot project; ten more enterprises will be selected for privatization. The authorities appreciate the Fund's recent technical assistance on SOEs, and work is in progress on integrating staff's recommendations on strengthening SOE oversight and governance in their program documents.

Creating a liberalized market and developing an enabling regulatory framework for private sector development is one of the key objectives. Continuous efforts are being made to improve the business climate and regulatory quality, aiming at ensuring consistent, predictable and efficient enforcement. Progress in this area led to Belarus' World Bank's Doing Business ranking moving from 57 in 2015 to 44 in 2016; further reforms have been identified by the World Bank staff for the upcoming Doing Business Report 2017. Cross cutting work to improve the business climate will be accompanied by catalytic reforms to accelerate the development of the SME sector.

The utility tariff reform is high on the agenda. Given the high social sensitivity of reforms in the sector aimed at reaching full cost recovery by end 2018, a phased approach has been chosen. The authorities raised the utility tariffs in January 2016 to reach an increase in cost coverage by 10 percentage points. The next steps were to review the costs of utility companies based on an earlier pilot project in the sector and to develop a strong social safety net, including putting in place a social assistance scheme to target the most vulnerable segments of the population during subsequent tariff increases. As a result of the rationalization of costs associated with the provision of utility services to households, cost coverage in 2016 will reach at least 50 percent, and the non-cash household subsidy system will be operational by October 2016.

External Partnerships

Enhancing the cooperation with international partners is essential to ensure that reforms are mutually reinforcing and irreversible. The World Bank Group's continuous engagement

has been highly instrumental for informing the implementation and design of ongoing and planned reforms. The Bank's financial support for enhancing competitiveness and private sector development is in the Bank's lending pipeline for Belarus. The Bank's analytical and advisory services and technical assistance programs included a Roadmap for Structural Reforms in March 2015 and four other major reports covering key aspects of structural reforms, including SME development, insolvency reforms, labor markets, regional development, governance of SOEs, and WTO accession. An extensive advisory work on public financial management was supported by the Bank's lending operation to help strengthen policy alignment of the budget, improve budget transparency, and lay the foundation for putting in place an Integrated Financial Management Information System. **With a €471 million** current portfolio of projects, the EBRD has recalibrated its operations in Belarus to focus more on bringing new investors for private sector development and facilitate public-private partnerships under the recently adopted PPP law. There is a regular dialogue with the EU and bilateral partners on structural reform and governance issues. Belarus has also intensified its efforts to move ahead with the WTO accession negotiations. Belarus entered into a new program with the Eurasian Fund for Stabilization and Development (EFSD), which incorporates policy action across the macroeconomic stabilization and structural transformation spectrum, and has successfully completed two reviews under the EFSD's \$2 billion financing facility.

A Fund-supported program for Belarus would play a catalytic role in pursuing the reform agenda. The Fund's responsiveness is very much appreciated. The authorities have benefitted from intensive technical assistance and regular consultations with the Fund staff and are committed to implementing the Fund's policy advice. The authorities' responses to past policy recommendations were broadly consistent, as is well described in the staff report. A Fund-supported program would help solidify the gains of the adjustments and contribute to building strong macroeconomic fundamentals. A program with the Fund would also send a strong positive signal to the general public and international business community. Given that Belarus has advanced appreciably in macroeconomic stabilization and that the structural agenda is currently being mainstreamed in the national social and economic development program, the authorities reiterate their strong commitment to reforms and look forward to reengaging in negotiations on a Fund-supported program.