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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 09/3-1

10:50 a.m., January 12, 2009

1. Republic of Belarus—Request for Stand-By Arrangement

Documents: EBS/09/1 and Correction 1, and Supplement 1, and Supplement 2; SM/09/4

Staff: Kähkönen and Mates, EUR; Prokopenko, MCM; Arvanitis, SPR

Length: 1 hour, 55, minutes

Executive Board Attendance

T. Kato, Acting Chair

Executive Directors	**Alternate Executive Directors**
	M. Majoro (AE)
	K. Assimaidou (AF)
	D. Vogel (AG)
	Y. Ha (AU), Temporary
	J. Prader (BE)
P. Nogueira Batista, Jr. (BR)	
	J. Yang (CC), Temporary
	A. Guerra (CE)
	P. St-Amant (CO), Temporary
A. Fayolle (FF)	
	C.Dahlhaus (GR), Temporary
	N. Choudhary (IN), Temporary
	M. Xafa (IT)
	Y. Shinagawa (JA), Temporary
J. Mojarrad (MD)	
	S. El-Khouri (MI)
A. Bakker (NE)	
J. Henriksson (NO)	
A. Mozhin (RU)	
	A. Al Nassar (SA)
P. Warjiyo (ST)	Adrian Chua (ST)
T. Moser (SZ)	
	D. Heath (UA)
A. Gibbs (UK)	

S. Anjaria, Secretary
T. Orav, Assistant

Also Present
IBRD: L. Bouton, S. Kulyk. European Department: M. Belka, A. Gulde-Wolf, M. Hassine, J. Kähkönen, N. Koliadina, N. Mates. External Relations Department: A. Gaviria, C. Jarvis. Fiscal Affairs Department: R. Velloso, A. Wane. Finance Department: D. Andrews, M. Rossi, S. Williams. Legal Department: C. Ogada, P. SenGupta. Monetary and Capital Markets: M. Erbenova, B. Johnston, Y. Makarova, V. Prokopenko. Office of the Managing Director: C. McDonald. Secretary's Department: P. Gotur. Strategy, Policy, and Review Department : A. Arvanitis, K. Hosono, D. Kovtun, B. Mukhopadhyay. Western Hemisphere Department: A. Alichi. Senior Advisors to Executive Directors: A. Joseph (BR), M. Kaplan (UA), B. Lischinsky (AG), S. Nget (ST), L. Palei (RU), N. Raman (ST), N. Riad (Mi), S. Rouai (MD), M. Sidi Bouna (AF), F. Spadafora (IT), A. Tolstikov (RU), R. Weber (SZ). Advisors to Executive Directors: G. Drummond (UK), P. Gasiorowski (SZ), O. Hendrick (AG), M. Jakoby (BE), A. Jbili (MD), G. Jung (SZ), P. Kanithasen (ST), A. Lahreche (FF), E. Lambregts (NE), L. Lephoto (AE), S. Lin (UA).

1. REPUBLIC OF BELARUS—REQUEST FOR STAND-BY ARRANGEMENT

Mr. Kiekens and Mr. Prader submitted the following statement:

The Belarus authorities thank management and the staff for the constructive discussions and for supporting their request for a Stand-By Arrangement. All policy measures critical for stabilizing the economy and for addressing a number of structural problems were formulated as prior actions and have already been implemented. The authorities are committed to pursuing the policies as outlined in their Letter of Intent and to adjusting the policies as needed, in consultation with the staff, in order to achieve the program objectives.

The authorities are proud of Belarus' economic performance during the last five years. In this period, GDP rose by 60 percent in real terms. This is one of the best performances in the CIS countries, which was characterized by a high level of investment and reducing energy intensity combined with strong improvements in labor productivity. This justified the significant increases in wage levels. At the same time, the authorities were able to manage the economy prudently. At the end of 2008, the gross general government debt was 6 percent of GDP, down from 11.6 percent in 2007, while external debt stood at 25.3 percent of GDP, down from 28 percent in 2007. Moreover, the overall public balance sheet of Belarus is strong because, as the staff rightly points out, the various public enterprises have substantial value.

However, the authorities recognize that the economy faces huge vulnerabilities because of the global financial and economic crisis and the limited capacity to cover the significant balance of payment needs. The Staff Report documents well the nature and sources of these vulnerabilities.

In August 2007, during the last Article IV consultation, the staff and the Board had recognized that the peg of the ruble to the US dollar had served Belarus well and that there was no need for an adjustment of the nominal exchange rate.

Indeed, a year later, circumstances have changed. In Box 1 of their Report, the staff has assessed that the real effective exchange rate is now—most likely—overvalued in the order of 11 to 20 percent. The authorities agree that preserving and restoring external competitiveness is critical for addressing Belarus' balance of payments need. They also agree that the most significant part of their strategy should be policy adjustment rather than financing. However, determining the size of the necessary exchange rate adjustment has been a particularly complex and difficult part of the program negotiations.

The staff has calculated that, under the macroeconomic balance approach, the REER is above equilibrium by about 11 to 14 percent. A similar conclusion follows from the external sustainability approach. If one assumes an appropriate but still prudent negative net foreign asset position of 40 percent of GDP, the currency is deemed to be 13 percent overvalued. Lastly, the wage-based model shows an overvaluation of around 11 percent, if dollar wages would reach $570 per month, as originally announced by the President.

The authorities agree that the exchange rate regime needs to be made more flexible. This was also advised by a number of Directors during the last Article IV consultation discussion. Hence, since early January 2009, the currency is no longer pegged solely to the US dollar but to a basket of currencies, i.e. the US dollar, the euro and the Russian ruble, with each currency having a one third weight. Moreover, the fluctuation band on both sides of the central parity has been widened to 5 percent. This creates more room to absorb shocks through moderate exchange rate adjustments.

The authorities also agree to the need for some moderate step adjustment in the nominal parity rate. Indeed, staff calculations point to only a limited overvaluation. Because of the very open nature of the Belarusian economy, any significant devaluation would result in a significant rise in the price of imported inputs that affect the cost of exports, which Belarus is unlikely to reflect fully in its export prices, given the prevailing conditions in world markets. Moreover, any significant devaluation will also considerably complicate the maintenance of low inflation, thereby drastically eroding the initial competitiveness gain of the exchange rate measure.

The authorities accept that for Belarus wage constraint is far more effective to preserve external competitiveness than a nominal exchange rate devaluation. Hence, the authorities have reversed most of the already announced public sector wage increases of October 2008 and have decided to limit them to 5 percent. This was a very bold measure, which largely preserves the equilibrium wage level as shown in Box 1 of the Staff Report. The measure also invalidates staff conclusions about the REER under the wage-based model, as it assumes the full implementation of the wage increase to $570. In Belarus, wages in state-owned enterprises and in the private sector largely follow increases in public sector wages.

Although initially, the authorities strongly preferred to limit the devaluation to 10 percent, they have now agreed with the staff's condition of a 20 percent devaluation, implemented on January 1, 2009. This was done simultaneously with the introduction of the currency basket.

It was a difficult judgment to balance the desire to limit the devaluation to what seemed necessary for preserving competitiveness with the need to avoid the perception of depositors that too small a devaluation would be followed by subsequent devaluations, thereby triggering a conversion of ruble deposits into foreign currency. Developments in the exchange rate in neighboring countries and the need for rather significant exchange market interventions in November and December were factors that tilted the balance toward a bolder exchange rate adjustment of 20 percent.

The wage decision, and to a lesser extent, the exchange rate adjustment, are critical measures for limiting the trade deficit. Continued strict fiscal, monetary and credit policies will be equally necessary to limit the balance of payments deficit and preserve the confidence of depositors in the currency.

The central government budget for 2009 aims at a balanced outcome and discontinuation of directed lending through banks. This implies a reduction of overall state funding by 3 percent of GDP, as compared to the funding in 2008. Paragraph 13 of the Memorandum of Economic and Financial Policies details the most important measures that should help reach this fiscal target. It is worth noting that under the baseline scenario of the public debt sustainability analysis (Table I.2 on page 48 of the Staff Report), public sector debt is projected to drop to 4.1 percent of GDP this year before reaching only 1 percent of GDP in 2012.

Monetary policy will target an inflation of about 11 percent by end 2009. Tight monetary policy will imply positive interest rates that will be transmitted to the real economy by abolishing interest rate ceiling on loans by banks to the corporate sector. Finally, the central bank policy rates will also be set to ensure the build-up of international reserves. Consistent with this stance, the central bank raised its key interest rates in early January following the adjustment of the exchange rate.

Tight macroeconomic policies and the exchange rate measure are projected to result in a correction of the current account, compared with the baseline, of $4.3 billion, or about 7.5 percent of GDP. A major part of this correction results from very tight wage, fiscal and credit policies. The remaining financing gap in 2009 is scheduled to be filled by a possible loan from Russia in an amount of $1 billion, or 1.75 percent of GDP, and by drawing on the Fund in an amount of $2.1 billion, or 3.6 percent of GDP.

Belarus' program is not limited to what are indeed many bold measures of aggregate domestic demand constraints. The program also includes significant structural reforms.

One important set of structural measures relates to the financial sector. As mentioned above, interest ceilings for bank credit to the corporate sector have been abolished, as are directed credits, except for credits by the central bank to the non-financial sector which will be discontinued beginning in 2010. Both central and local governments will no longer maintain deposits with commercial banks. Other important measures relate to the process of privatizing the large state-owned banks, as detailed in paragraph 11 of the Memorandum of Economic and Financial Policies.

Other reforms will improve the business climate and governance of the economy. Price controls were reduced last year. Regulation limiting monthly price increases to no more than 0.5 percent will not be extended beyond March 2009. In 2010, mandatory wage policy in companies where the government has a majority control will be discontinued. More generally, the government is in the process of implementing a comprehensive plan for both creating a favorable investment and business climate and putting in place mechanisms and instruments needed for the private sector to develop. In particular, the government will create an attractive environment for foreign investment. In this vein, the turnover tax will be halved in 2009 and the local sales tax and the effective personal income tax rate reduced. The privatization of companies and banks will be accelerated. More generally, the state will reduce its control and influence over productive enterprises, while improving governance and legal structures that create a level playing field for economic agents.

To make progress with these and other structural reforms, the government is seeking closer cooperation with and lending from the World Bank and the EBRD. The government is also implementing agreed measures that are facilitating closer cooperation with the European Union. As mentioned in the Staff Report, after the expiration of this Stand-By Arrangement, the government will consider requesting, in early 2010, a successor IMF arrangement, possibly an Extended Fund Facility (EFF), to further advance the transition toward a well-functioning market economy and improve access to international capital.

Mr. Kishore and Mr. Choudhary submitted the following statement:

We have gone through the staff papers and thank Mr. Kiekens and Mr. Prader for their informative and helpful statement. The largely state controlled economy of Belarus has experienced rapid economic growth in recent years, but of late had shown strong signs of overheating. The global economic crisis has really hit hard Belarus, as falling demand for its exports, adverse terms of trade and the lack of external financing have led to a sharp decline in the country's international reserves.

Financing Need and the Size of the Fund Assistance

The authorities have requested a 15-month SBA with exceptional access from the Fund for $2.5 billion, out of a total financing need of $20.2 billion with front- loading of around $800 million. Compared to some other recent cases, this amount is somewhat smaller both in terms of quota (418.77 percent of the quota) as well as in terms of the total external financing requirements (around 12.4 percent), with relatively tougher conditions. We note from Mr. Kiekens' and Mr. Prader's statement that a number of critical policy measures agreed upon to stabilize the economy and address structural problems have already been implemented as prior actions. Staff may provide more clarity on how the large financing gap could be fully met and update the progress made and indicate prospects of possible financing by the World Bank and other multilateral and bilateral sources.

Exchange Rate

We note that Belarus's real exchange is most likely overvalued in the order of 11 to 20 percent and concur with the staff that shift to a more robust and flexible exchange rate framework will help the economy to adjust, help restore competitiveness and address external balances. Monetary policy will need to defend this regime. Institutional capacity building and reforms will be required to make the transition to flexible exchange rate seamless. We note that as prior action, authorities have allowed Belarusian ruble to devalue by 20 percent with the simultaneous introduction of the currency basket. Staff may like to provide further update about its initial impact.

Fiscal Policy

Fiscal tightening will be required as the government's finances comes under increasing strains. The authorities decision to cut back subsidies, limit wage growth and reduction in directed lending program are steps in the right direction. In particular, the authorities bold decision to limit the public sector wage growth to 5 percent is commendable. We hope that the strengthened social safety net will take care of needy and vulnerable sections of population.

Banking Sector

The blanket deposit guarantee was perhaps needed to avoid a run on deposits. The decision to eliminate flow of new resources to directed lending and interest rate ceilings are welcome. We note the intention of authorities to prepare the roadmap for privatization of state owned banks. What are the prospect of early privatization of some of the state owned banks? We also welcome staff comments on the supervisory capacity and autonomy of Central Bank of Belarus.

Economic Liberalization

We welcome authority's decision to do away with price controls and to enhance the role of the private sector significantly. We hope that with these measures, the authorities will take a decisive and irreversible shift toward economic liberalization. Far-ranging economic restructuring, deregulation and a significant departure from existing policies may require strong political will and people's support. Staff comments are welcome on the effort to build consensus in favor of wide ranging economic policy changes.

With these observations, we wish the authorities well in their future endeavors.

Mr. El-Khouri and Ms. Riad submitted the following statement:

We thank staff for their reports and constructive engagement with the Belarusian authorities. We also thank Messrs. Kiekens and Prader for their very helpful and candid buff statement. Following several years of robust economic performance, the Belarusian economy is now confronted with severe challenges aggravated by the rapid deterioration in global economic and financial conditions. We share staff's assessment of the nature and extent of these challenges and vulnerabilities, which the proposed program aims to mitigate through a set of strong macroeconomic stabilization measures, as well as ambitious structural reforms. The fulfillment of a bold set of prior actions stipulated in the program lends credibility to the authorities' commitment to address underlying vulnerabilities through strong program implementation. We confine our remarks to a few issues for emphasis.

Program negotiations between the authorities and staff aimed to strike an appropriate balance between the needed degree of adjustment in the exchange rate and other policy measures. As noted by Messrs. Kiekens and Prader, and given the limited responsiveness of the current account to exchange rate adjustments, the authorities would have favored stronger wage restraint, which would justify a more modest exchange rate devaluation. In the event, the adjustment effort comprised both a substantial pullback in wage increases and a 20 percent devaluation in the exchange rate parity, together with a shift to a basket peg and widening of the band to ±5 percent. The staff supplement suggests that the exchange rate measure on January 1, 2009 did not result in a serious loss of confidence in the currency or the banks. Going forward, however, we remain concerned that the interest rate will have to bear an undue burden in supporting the new exchange rate regime.

We note that the focus of the program is on a strong adjustment effort rather than on financing. The program's strategy in adjusting to shocks relies on demand management measures, in addition to exchange rate realignment and wage restraint. It would be important that the program does not unduly choke off the economy, at a time when it would be contracting due to worsening external conditions. We take positive note of the program adjusters allowing for some easing in economic policies should additional financing be available. In this connection, it is unfortunate to note from paragraph 31 that "a Fund program could trigger additional financing by the EU and the World Bank, but these institutions are not prepared to make firm commitments at this stage." This has led the Fund to fill all of the remaining financing gap for 2009.

The Financial System Stability Assessment Update elaborates on the shocks that would stress the banking sector, including the 20 percent devaluation and a sharp increase in interest rates. Staff argue that the direct effects of the devaluation would be limited, but credit quality would deteriorate substantially due to the macroeconomic slowdown and increased interest rates. Banks are also vulnerable to a potential run on deposits or a significant reduction in external financing. Interacting these shocks would certainly stress banking sector balance sheets and liquidity indicators. We therefore support the preemptive measures that have been taken by the authorities to provide a capital injection equivalent to 2.5 percent of GDP to compensate losses that banks are likely to experience as a result of the shocks.

To contain the need for potential further capital injections, the phase-out of directed lending by state banks as stipulated by the program, will be crucial. Furthermore, the authorities' intention to set the stage for some form of privatization of state banks is a step in the right direction, although we agree that the pace of such privatization would need to take account of developments on the global outlook and resolution of global financial and banking sector dislocations. It is therefore important that the relevant structural benchmarks be set according to a realistic timetable.

With these remarks, we support the proposed decisions and wish the authorities well in their reform efforts.

Mr. Gibbs and Ms. Drummond submitted the following statement:

We support this program. The Belarus economy is clearly in need of profound reform, and this SBA is an important element in this regard. While we welcome the commitment shown by the Belarusian authorities in enacting prior actions to the program, we strongly underscore that continued implementation of the program, within the boundaries provided, is crucial if Belarus is to gain renewed access to external finance and investment. Structural reforms to liberalize the domestic and external sectors will be particularly important. As such, we would strongly support a second IMF program, such as an EFF, to help progress Belarus' structural transformation.

We note uncertainties around the delivery of additional support for Belarus, including further funding from World Bank, Russia, and other partners. What would be the impact if these funds were not forthcoming? Would this present a significant risk to the success of the program?

Macroeconomic

Although inflationary pressures may have eased a little recently, the removal of energy subsidies, a forecast moderate increase in oil prices over the medium term, and the recent devaluation, suggest that significant pressures are likely to remain. The forecast inflation rate of 11.5 per cent by end 2009 therefore seems optimistic—indeed, some analysts are predicting household goods to rise by 30-40 per cent. One analyst expected Belarusian inflation to rise to 30 per cent.

More generally, both Russia and Ukraine are experiencing falling levels of growth, with Ukraine, and possibly Russia, forecast for a contraction in 2009. This is likely to reduce export demand even further. Stocks of unsold goods rose by $350 million in October. Despite widespread uncertainty, the risks to the current account are definitely on the downside.

Having said that, the program seeks to provide contingency policies for worse than expected outcomes. These will obviously be key: more details on the "additional market-based measures" (¶13) would be useful.

Exchange Rate/Monetary Policy

We welcome the move to a basket peg, in line with the mix of major trading partners. Noting that black market trading has been reported, we stress that this should continue to be monitored to ensure the official rate reflects market valuations. The authorities should strive to make full use the +/- 5 per cent exchange rate band, as necessary, to help the economy better absorb further shocks.

We note that the outlook for Belarus is closely linked to Russia's economy and approach. Should Russia experience a disorderly devaluation, what impact would this have on Belarusian exports and what mitigating policies are in place?

Banking and Financial Sector

The SBA incorporates limited quantitative performance criteria focused on the curtailing of direct lending. Since we agree with staff that this is "crucial" to the reform of the banking system, we would be interested in staff views as to what indicators might be used to ensure this practice is reduced under the program.

We encourage the authorities to work with the IMF, the World Bank Group, and others to implement the recommendations of the recent FSAP on strengthening the financial system. This should include strengthening the independence of the National Bank Board and bank supervisory processes, ensuring adequate provisioning for NPLs, and developing an institutional framework to support supervision and crisis management.

Other

We welcome the recognition of the need to develop targeted social welfare. This will be required to cushion the worst affected from the impacts of what will be a severe downturn. We encourage the authorities to ensure that this is a priority area of spending.

Finally, we urge the Belarusian authorities to continue to engage with the wider international financial community, including the World Bank and the EU. We note the comments by the National Bank of Belarus that "the signing of an agreement with the IMF is a significant factor in the development of financial cooperation with major international organizations, the EU and other states." Given the importance of EU trade and aid policy to Belarus, it is important that both Belarus and the EU commit to open trade and investment flows. We therefore strongly encourage Belarus to implement the core principles of the International Labor Organization, as required to reverse the EC's temporary withdrawal of its Generalized System of Trade Preferences to Belarus.

Mr. Henriksson and Mr. Bitans submitted the following statement:

We support the authorities' request for the Stand-By Arrangement. The current vulnerabilities have to be addressed, and the envisaged policy measures under the program on the whole seem to be appropriate. Nevertheless, the program design raises a number of questions, on which we would appreciate staff's comments and clarifications.

First, while the country's recent growth has been rather impressive, external competitiveness needs to be improved. We note that the proposed step devaluation is expected to help address the competitiveness problem. However, it will also have an impact on inflation through rising import prices, further execrating the hikes in gas prices imported from Russia.

More generally, it seems that the country's competitiveness issues are more related to structural problems, and it is not immediately clear how those can be addressed by an adjustment in nominal exchange rate. Moreover, the proposed devaluation was supposed to stop the conversion of ruble deposits into foreign currency. The evidence so far seems to suggest that the risks still remain. Amid expectations of further exchange rate adjustments, there is a possibility that private sector savings may fall further, with negative short-term implications for the country's balance of payments. This would be somewhat contrary to what the program aims to achieve. Furthermore, we learn from the statement of Messrs. Kiekens and Prader that the 20 percent devaluation was not the authorities' preferred option initially. Against this background, we would be interested in staff's estimates on the likely impact of the proposed exchange rate adjustment on the country's net exports for 2009 and from a more medium-term perspective.

Second, while the fluctuation band around the peg was widened somewhat, it is not clear how much additional exchange rate flexibility this will provide, especially as the exchange rate approaches the limits of the band. In practice, as staff mentions, monetary policy will often be restricted by the need to support the demand for rubles, implying high interest rates for extended periods of time. As indicated by the FSAP update, this would have significant consequences for the country's banking system, which is already coping with the indirect effects of devaluation.

To address the liquidity issues, the NBRB has lowered mandatory reserve requirements. However, in circumstances when there is rising demand for foreign currency denominated assets, and when the central bank's stock of foreign assets is already low, we would advise against an active use of reserve requirements as monetary policy instrument.

We also note that the authorities, on top of their other objectives, aim at targeting a specific inflation rate. It would thus appear that the monetary policy is increasingly overwhelmed by many parallel and sometimes conflicting targets. The authorities should keep a set of priorities, and the overriding target for monetary policy under the current circumstances should be maintaining the new exchange rate regime.

Third, we fully agree with staff that directed lending through the banking system should be stopped. It is welcome that the government will stop financing these operations through state bank deposits. At the same time, we would like staff to elaborate further why the public capital injections in the state banks will be excluded from the program fiscal deficit targets. There are risks that allowing for such soft budget constraints will not help to solve the problems with incentives and risks managements in the banking sector that staff have rightfully identified. Staff's comments are welcome.

Fourth, we note from the program that the financing gap has not been entirely closed for 2010. The authorities plan to cover it by a possible EFF and by additional financing. However, under the current global financial market circumstances, it would be most prudent for the authorities to work under the assumption that no additional financing may be forthcoming. We note that the authorities are planning additional measures in this scenario, and we would be interested to hear from staff what those measures might entail.

Finally, we join staff in urging the authorities to address the remaining weaknesses with regard to the country's statistical data. On top of staff's concerns, we also note that some macroeconomic data, such as unemployment rate, do not seem to reflect the underlying macroeconomic developments. We would appreciate staff's views.

Mr. Vogel and Mr. Hendrick submitted the following statement:

Belarus' economy has been negatively affected by the combined trade and financial shocks, which are testing the resilience of the financial system and the limitations of the previous economic model. The low level of international reserves and the worsening prospects of external financing call for bold policy actions. The authorities' economic stabilization plan may contain the elements for a successful "soft landing," while addressing the main macroeconomic imbalances. The successful implementations of these actions will pave the way for a successor Fund arrangement, as highlighted by Mr. Kiekens and Mr. Prader in their candid and useful statement. We support the authorities' request for a Stand-By Arrangement and will only make a few comments for emphasis and clarification.

Exchange Rate Policy

The changes implemented in the exchange rate system seem to be a necessary decision given the current risks and vulnerabilities. The authorities need to remain vigilant to take additional actions if the market exchange rate is pegged to the ceiling of the band for sustained periods, which will entail additional losses of international reserves. By definition, the central bank will need to defend the ceiling of the band if the current measures are not enough. In this regard, we would like to hear from the staff how the exchange rate has been evolving in recent days and if the central bank has had to intervene in the foreign exchange market. Under what conditions and how often would the staff advise changing the parameters of the band? Also, would the staff recommend intramarginal interventions—within the band, and if so, under what circumstances? Perhaps the staff could elaborate on its comment that "realignment can quickly restore stability to the capital account—discouraging speculative outflows, primarily via conversion of ruble deposits into foreign currency".

We agree with the need to protect a minimum level of international reserves, but we need to be cautious about signals to the market. The market understands that in addition to a strong fiscal response, a sizable level of international reserves is also needed to maintain a commitment to a peg or a band. However, as in Latvia's case, we wonder whether the performance criterion on net international reserves and the related consultation clause, should they fall below the established floors, would exacerbate financial speculation and lead some to bet against the domestic currency, given the fragility in the banking system and the commitment to defend the ruble. The staff's comments are welcome. Meanwhile, we tend to agree with Mr. El-Khouri and Ms. Riad that "the interest rate will have to bear an undue burden in supporting the new exchange rate regime."

Regarding Fund policy recommendations on exchange rate regimes, although Latvia is a different case, we cannot avoid expressing a degree of surprise at the strong defense of the peg-system in the first case and the less sanguine approach in Belarus' case. We understand the differences in their economic structure, but also their similarities. We should recognize that this is an issue that will require a transparent and comprehensive explanation from the Fund. We are a little concerned about recent official statements underscoring that "devaluation was IMF demand," which may undermine the required image of strong ownership and commitment to the program, crucial for the success of the government's strategy.

Financial System

We welcome the authorities' decision to improve the banking supervisory and regulatory framework and recommend caution with contingency fiscal costs to help ailing banks. The decision to provide a blanket deposit guarantee was a timely and prudent decision to avoid losses in deposits and confidence. However, as it is clear from Box 2, Banking Sector Stress Tests, the 20 percent devaluation that already took place and the 400 bps increase in the interest rate will most likely produce some of the results shown in the simulation, namely that more banks will need additional capital injections to restore capital adequacy ratios. We would appreciate the staff's clarification on whether these additional fiscal costs were already contemplated in the staff's projections.

We note that Belarus' capacity to repay the Fund will mainly depend on a large current account adjustment and significant economic reforms. However, taking into consideration that significant access to capital markets is unlikely until further structural reforms enhance Belarus' attractiveness to foreign investors, we encourage the authorities to build a strong consensus among the civil society to sustain a relatively long period of stabilization and reform.

With these remarks, we wish Belarus success in their challenging endeavors.

Mr. Warjiyo and Mr. Kanithasen submitted the following statement:

We thank the staff team for their hard work in crafting this program, particularly in view of the current time and resource constraints. We also thank Messrs Kiekens and Prader for presenting the authorities' perspective in their very helpful statement.

We are sympathetic to the people of Belarus. The economy has enjoyed impressive growth in recent years but as a very open economy, it has succumbed to the consequences of the global financial crisis. We believe that the stand-by arrangement agreed by staff and the authorities, though ambitious, should be able to address current vulnerabilities of the Belarusian economy and gradually pave way for further market-oriented transition. We agree that an SBA, with a possible EFF when the stabilization program achieves its goals, is the right instrument in this case. We understand well that the adjustments are going to be difficult but are encouraged by the first—and very bold—steps taken by the authorities earlier this month, as outlined in Messrs Kiekens' and Prader's statement. Given the commitments declared, and full implementation of agreed prior actions by the authorities, we are confident that the objectives of the program would be met, thus assuring adequate safeguards to the Fund's resources. Further, Belarus' low indebtedness assures us that risks to the Fund are manageable. We therefore support the request by Belarus for the Stand-By Arrangement involving exceptional access.

On "exceptional access," we take note that two of the four criteria have not been met. Nevertheless, we wish to highlight that were this request of 418 percent of quota made after next week's Board's discussion on enlarging access, then the four criteria might not apply. In any case, we would not want to preempt future Board decisions, and we would still show flexibility regarding the two criteria that have not been met. This is because Belarus' economic circumstances are such that developments are driven by large flows in the current—rather than capital—account, and is not reliant on foreign financing. Hence, we think there is an argument to be more lenient on the application of Criteria 1 and 3 in this particular exceptional access case.

Concerning the financing requirements of Belarus, staff pointed out that in addition to Russia, the European Union, and the World Bank may commit to providing assistance. Are there any further developments on these proposed arrangements?

We would like to comment and seek further clarifications regarding the details of the stand-by arrangement and latest developments from staff as follows:

- Adjusting the exchange rate: We are encouraged that the authorities have taking the drastic but necessary step in devaluing the ruble in relation to the US dollar earlier this month, and we understand there has been some political fallout arising from this action. Are there any additional pressures on the currency? How do staff view the impact on the already-high inflation and on household and corporate balance sheets? Would this step change bring the ruble closer to a sustainable level?

- Setting up a new exchange rate regime: We agree in principle that the new regime should take into account Belarus' trading partners. Could staff explain the rationale behind giving equal weights to each of the three currencies in the basket? What are staff view's on the new exchange rate outlook in light of the current volatility of the Russian ruble, which now forms a third of the currency's value?

- Mitigating external vulnerabilities: We underscore the need for the NBRB to increase its reserve holdings. Given the country's reliance on foreign trade and its currency peg, why were reserves so low in the first place? We agree that one of the reasons for the strong economic performance in the past years was from the purchase of fuel at preferential prices from Russia, which will be phased out by 2011. We are encouraged that steps have been taken in moving toward a sustainable market mechanism. Nevertheless, we are concerned that there may be repercussions on Belarus as one of the main transit countries for fuel. What effects on the Belarusian economy do staff foresee as imported fuel prices are liberalized?

- Tightening monetary policy: We agree that monetary policy in the immediate term should be focused on supporting the ruble and limiting inflation. Having said that, we wonder if the targeted inflation rate is too high. We agree that prices are likely to spike but as domestic demand contracts, pressures should ease. The question is why staff do not see the rate falling even further. Is it because the impact of the downturn on growth is expected to be modest?

- Tightening fiscal policy: We believe that the authorities are on the right track by making fiscal adjustments through stricter discipline and a tighter stance through a balanced budget. On one hand, the fiscal restraint by the general government has helped keep debt levels low and provided some flexibility. However, we also note that much of the fiscal impulse in recent has come from quasi-fiscal activities through government-directed bank lending, which is where the real restraint will need to be shown. Are these directed loans covered by any government guarantees, whether explicit or implicit? What is the likely scale of any contingent liabilities, and would that change the picture for public debt?

- Limiting public investment: We note that staff seem to only envisage a very modest decline in investment. Given the country's high rate of public investment and the limited role of foreign investment, how likely is it that private investment could be sustained, especially in view of a scale-back in bank lending? We remain skeptical that investment and growth in 2009 would be only modestly weaker and invite staff to comment on the balance of risks.

- Restraining wages: We commend the authorities for having taken bold measures as prior actions, particularly to limit previously announced wage increases and to control further wage rises. As such steps – however necessary they may be— tend to be very unpopular, how do staff see political risks? In light of this deep decline in real wages, we are surprised to see private consumption only projected to decline by 1 percent in 2009 before rebounding in 2010. Again, this seems optimistic to us.

- Enhancing the social safety net: The importance of strengthening the social safety net under a period of drastic adjustment in any crisis country cannot be over-emphasized. We note that the budget for social expenditures for 2009 has not increased in relative terms compared with 2006 and 2007, when the economy was booming and the needs were lower than during the crisis. Can staff provide further clarification on this?

- Reforming the financial sector: In the midst of the challenges facing Belarus, we are encouraged by the relative strength of the banking sector as highlighted in the FSSA Update and by the authorities' actions to mitigate banking losses resulting from economic shocks. We think the proposed performance criteria to bring practices in line with international norms are appropriate. While appreciating the already-substantial resources used to recapitalize Belarusian banks so far, more may need to be done, which is another reason to maintain fiscal discipline. Yet this does not address the inherent problem of excessive state involvement in the banking sector. We are pleased that the government is phasing out its involvement from lending and accelerating the privatization of state banks. As underscored by staff, this the sequencing for such liberalization has to be carefully thought out. Given the intrinsic involvement of the state in the banking sector, a too-rushed exit would likely have adverse repercussions. We are therefore glad to see that explicit privatization plans are not in the current program and would be implemented when conditions allow. The suggested action—engaging advisors to prepare for privatization when conditions permit—is realistic and reasonable. Having said that, we are surprised that this action was listed as a benchmark and not a performance criterion. Staff elaboration in this regard would be welcome.

With these remarks, we wish the authorities every success on their path to recovery.

Mr. Stein and Mr. Dahlhaus submitted the following statement:

We thank staff for their thorough analysis and broadly concur with their assessments and recommendations. We also thank Mr. Kiekens and Mr. Prader for their insightful statement. Now that a deteriorating external environment has led to unfavorable developments in foreign trade and sources of external market-based financing have dried up, Belarus faces serious balance of payments needs. Against this background, we can support the authorities' request for a Stand-By Arrangement with exceptional access under the exceptional circumstances clause. However, in view of the high level of access, we underscore the crucial importance of the authorities' ownership of and continued commitment to the program.

With headline inflationary pressures still high, we concur with staff that abandoning the exchange rate peg as a nominal anchor would be premature. We therefore consider the one-time devaluation combined with a shift of the peg to a new currency basket a rightful step in order to better reflect Belarus' foreign trade profile. Nevertheless, as the development of the country's terms of trade is dominated by movements in energy prices, which have recently become more volatile, and the still ongoing price adjustment of imports from Russia, the question remains whether the widened band of +/- 5 percent provides enough flexibility to sufficiently absorb future shocks. It might therefore be advisable to aim at a gradual shift toward even greater exchange rate flexibility in a medium-term perspective.

In addition, we welcome the recent strengthening of monetary policy and encourage the authorities to take further steps in the event of a resurgence of pressure on the currency and in case headline inflation does not abate as predicted. Moreover, we welcome the authorities' intention to only gradually reduce interest rates once the balance of payments position improves, as this will help to gain credibility—a necessary precondition to enable greater exchange rate flexibility over the medium term as well as to secure financial sector stability.

We also support the recommendations in the FSAP update, which are focused on cutting back the influence of the official sector on the banks' lending policy as well as on strengthening the institutional framework. Currently, the financial sector appears to be the most vulnerable part with regard to macroeconomic stability as credit and liquidity risks have accumulated. With regard to the program targets, we therefore welcome the structural benchmarks and encourage the authorities to fully implement them on a timely basis. Nevertheless, we wonder why the strengthening of the independence of the NBRB Board and the central bank's supervisory processes have not been included in this list (or more appropriately as a performance criterion)—despite having been classified in the FSAP update as a high priority issue. Staff comments are welcome.

Furthermore, we concur that fiscal tightening is needed to align demand with external financing constraints. We therefore acknowledge the planned reduction in directed lending and a prudent wage policy in the broader public sector which results in a necessary reduction in quasi-public demand. We join staff in welcoming the intended review of the social safety net in cooperation with the World Bank, as the number of people in need is likely to increase as a consequence of the impending economic adjustments. Furthermore, we encourage the authorities to engage in further fiscal strengthening should the current adjustments prove to be insufficient in order to avoid additional balance of payments needs.

On a more general level, we encourage the authorities to take the current situation as an opportunity to enact further structural reforms with the medium-term goal of greater price and wage liberalization. Although we agree that precipitous implementation should be avoided amid the difficult external environment and substantial uncertainty surrounding the economy, reducing the size of the government, deregulation and privatization are all essential measures toward the goal of making full use of Belarus' growth potential in the future.

As a matter of principle, we consider it premature to toy with a successor program before the impact of the currently proposed SBA is seen.

Finally, the reference made in Box 3—assessment of the exceptional access criteria while at the same time referring to the flexibility granted under the exceptional circumstances clause—is confusing and we would welcome clarification.

Mr. Rutayisire submitted the following statement:

We thank staff for an insightful report and Mr. Kiekens and Mr. Prader for their helpful statement.

Belarus' real GDP growth is projected to decline sharply in 2009 to 1.4 percent from 10.5 percent in 2008, as a result adverse terms of trade shocks, and a decline in external demand which have increased the country's economic vulnerabilities. International reserves, already low, have declined to less than one month of imports cover in 2008. Financial sector vulnerabilities have added to external vulnerabilities.

Against this backdrop, we welcome the authorities' new program which—with the support of the Fund—will help facilitate an orderly adjustment to external shocks and address vulnerabilities through a combination of exchange rate and fiscal adjustments and tighter wage policies. The move to a more flexible exchange rate regime should help reduce the pressures on the current account. The shift toward a market-based financial system will contribute to strengthening financial sector vulnerabilities.

We support the authorities' request for an SBA in view of their strong program and their external financing needs.

Fiscal Policy

We welcome the authorities' measures to balance the budget in 2009 from a deficit of 0.8 percent in 2008, and their commitment to a prudent wage policy. A tighter fiscal stance will help bring demand in line with external financing constraints. The planned reduction in directed lending through state banks will also be key.

To ensure that the most vulnerable people are protected against the economic downturn, we also welcome the planned review of the social safety net, in cooperation with the World Bank.

Exchange Rate Regime and Monetary Policy

The realignment of the parity that accompanied the shift to a more flexible exchange rate regime should contribute to restore competitiveness and address external imbalances while the new currency basket and wider bands should help the economy absorb external shocks.

The authorities' interventions to defend the new exchange rate regime are appropriate including through the increase in interest rates before the shift to a more flexible regime. We welcome their commitment to gradually reduce interest rates once the balance of payments position improves.

We commend the authorities for implementing a deposit guarantee scheme which should help prevent a liquidity crisis but we would also like to encourage them to strengthen supervision in cases where liquidity is provided via uncollateralized lending. We also urge them to bring the classification and provisioning for NPLs in line with the best international practices, and to carefully scrutinize bank capitalization.

Structural Reforms

We welcome the authorities' commitment to the implementation of structural reforms, and agree that these reforms need to be sequenced carefully given the current difficult environment. We agree that the program to enhance the private sector through deregulation and privatization should be undertaken only when market conditions permit. Price and wage liberalization should also be implemented gradually following the realignment of the currency.

With these remarks, we wish the authorities success in their future endeavors.

Mr. Lee and Mr. Ha submitted the following statement:

We thank staff for the paper and Messrs. Kiekens and Prader for the helpful statement.

We support the authorities' request for a 15-month Stand-By Arrangement, which appropriately addresses the immediate vulnerabilities that should enable macroeconomic stability to be restored in the face of current external shocks. The program contains an appropriate balance between policy adjustment (via real exchange rate realignment, moving to a basket peg, and wage/fiscal restraint) and financing, with sufficient flexibility in view of the uncertainties.

However, we note that there remains a residual financing gap of around SDR 500 million for 2010. An update on prospective EU and World Bank assistance for Belarus would be appreciated.

This program, as with other recent programs, is subject to significant downside risks and unwavering commitment to the reforms will be required. In this regard, we are reassured by the authorities' completion of all prior actions and their commitment to take additional policy measures, if necessary.

We can accept the proposed limited structural conditionality in the program in the context of what can be feasibly expected of the authorities over the prevailing 15-month timeframe. We see this as laying the groundwork for further needed structural reforms, which would be addressed in a successor Fund program.

We wish the authorities success.

Mr. He and Ms. Yang Jiehan submitted the following statement:

With the deepening global financial crisis, Belarus' underlying economic vulnerabilities have exposed it to adverse trade and financial shocks. As the Fund's assistance is necessary to facilitate policy adjustment in Belarus to restore macroeconomic stability and reduce vulnerabilities, we support the proposed program. The authorities' policy strategy that centers on improving exchange rate flexibility and advancing structural reforms is broadly appropriate. We particularly applaud their prompt implementation of all prior actions.

The adoption of a more flexible exchange rate regime is necessary to absorb external shocks. The twenty percent one-time devaluation of the Belarus ruble is a bold measure. We are heartened by staff's observation that monetary and reserve data so far do not show any serious loss of confidence in the currency or the banks after the measure. However, as rumors of further devaluation linger and could trigger further ruble deposit withdrawals, the authorities should pursue a clear and consistent communication strategy. We agree that the monetary policy should support the new exchange rate regime and facilitate a build-up of international reserves; we also welcome the recent interest rate hike that reduces inflation pressures from the devaluation.

A prudent fiscal stance is crucial to reduce domestic demand and narrow the current account deficit. The authorities' action to reverse the wage hike decision is encouraging. As we note that subsidies will also be curtailed in the revised 2009 budget by one percent of GDP, we would like staff to elaborate on the target for the cut. As bank recapitalization costs are excluded from the 2009 zero deficit target and capital injection to state banks at the end of 2008 amounted to $1.5 billion, should recapitalization costs and contingency liabilities in state banks increase with further deterioration in the external and domestic economic and financial environments, how would it affect the budget?

We welcome the authorities' plan to accelerate structural reforms as they are pivotal for enhancing long-term growth prospects. While price liberalization and private sector development need to be sequenced with the overall macroeconomic stabilization strategy, financial sector reforms remain a top priority as deteriorating external conditions have heightened liquidity and credit risks threaten financial stability. We are pleased with the authorities' efforts to strengthen the framework for crisis preparedness and management, and their intention to phase out directed lending through banks. The plan to transform state banks into market-oriented entities by attracting foreign investment is heartening, but the pace has to be aligned with developments in the global financial market.

Staff estimate that Belarus will face a very large financing gap till 2010. While we would like staff to detail the current available external financing of $4.2 billion for 2009, we note that the SBA has to play a strong catalytic role.

The significant risks to the program, including high uncertainties in external economic and financial developments require strict implementation. We welcome the authorities' readiness to take additional measures if necessary to keep the program on track.

Mr. Guerra submitted the following statement:

We commend the authorities for taking the necessary measures to confront the immediate economic challenges and to put the economy back in the correct track. We support the request for the Stand-By Arrangement. Although staff describes the proposed financing as relatively front loaded because of the timing of the disbursement of resources, we believe that this has been outweighed by the implementation of critical policy measures to stabilize the economy as required by the prior actions. These measures and the strong commitment of the authorities will reflect in a much more resilient economy, able to better cope with the present extreme global financial volatility.

We support the overall staff appraisal and have the following comments with respect to the program:

Fiscal restrain and quasifiscal operations: the authorities have to be commended for their efforts on fiscal restrain with a balanced programmed budget. Looking forward it would be important to further support fiscal consolidation by taking into consideration all contingent public sector liabilities and quasi fiscal operations. The elimination of further public sector transfers/deposits in commercial banks is an important first step. Nevertheless, the public sector should keep close track of any implicit warranty extended by the government to financial intermediaries and improve the monitoring of public expenditures. In this regard, IMF technical assistance can play a supporting role in helping the authorities to avoid contingent fiscal risks and arrears.

Monetary policy: the NBRB has demonstrated its commitment to attaining the programmed inflation target by raising interest rates. The NBRB should also stand ready to infuse liquidity to banks if necessary, requiring the appropriate collateral. Nevertheless, it will be important for the monetary authority to abstain from other type of financing to the domestic sector. In this regard, we are assured by the authorities commitment to gradually disengage the NBRB from direct lending to non-financial organizations.

Financial sector and structural reforms: We agree with Mr. El-Khouri and Ms. Riad that the privatization of banks is a step in the right direction and that the pace of such privatization would need to take account of developments in the global outlook. Furthermore, it is important in this process to give priority to developing an efficient and competitive financial sector. Other considerations, although important, should not guide the structural reform process (like the aim to increase fiscal income). In general, we highlight the staff’s argument that the structural reforms should be carefully sequenced and implemented.

Finally, it is essential that the Fund sends a clear message of support to Belarus and the authorities' ownership of the program. In these uncertain times we should not miss the opportunity to remind our membership that we will support them not only with financial resources but with policy advice that takes into consideration the necessary flexibility to obtain macro financial stability in very difficult times. We also fully support the authorities' efforts to strengthen the social safety net for the most vulnerable sector of the population.

With these comments we wish the authorities success in their endeavors.

Mr. Bakker and Mr. Lambregts submitted the following statement:

In discussing this Fund program, we want to express our deep concerns about the political situation in Belarus. Decisive progress is needed in strengthening democratic institutions, respecting human rights, and improving the rule of law. In the same spirit, we urge the authorities to increase transparency and accountability of public institutions.

The authorities face great challenges to adjust the economy to external shocks and to reduce home-grown vulnerabilities related to the all-encompassing role of the government in economic life. With the economic program that is presented, it appears the authorities are willing to make important steps in the right direction to address these challenges. Based on the expectation that this program will be implemented appropriately, we support the authorities' request for a Stand-By Arrangement.

We welcome the move to a more flexible exchange rate regime, as this will provide Belarus with room to absorb shocks. While recognizing the adjustment made as well as the need for a nominal anchor, the new peg may become untenable in view of the risk of internal capital flight and the country's low international reserves. Experience in other countries shows that an adjustment of the exchange rate and higher inflation can encourage dollarization. How does staff assess the likelihood of this risk and what would they recommend the authorities if this risk would materialize?

We support a tighter monetary policy not only to support the new exchange rate regime but also to tame inflation. In fact, underlying inflation might be higher than reflected in the figures, given the government's firm grip on prices. While slower output growth and softer commodity prices could lower inflation going forward, a more substantial decline in price pressures could be impeded by lower energy subsidies from Russia, steeper utility tariffs and the removal of the ceiling on monthly price increases.

To improve competitiveness through labor costs and to keep public finances on a sustainable footing, we subscribe to a tight fiscal stance. While headline figures of gross public debt are low, they disregard the large contingent liabilities in the corporate and financial sector. The ageing population of Belarus also argues for continued fiscal savings to counter the rising costs of health care and social security.

We welcome the strengthening of the framework for crisis management in the financial sector as reflected by the introduction of a blanket deposit guarantee and tools for the central bank to quickly deploy liquidity. For crisis prevention more actions are required. Recapitalization of large state banks would need to be accompanied by improved risk management and prudential regulation. Persistent capital injections in state banks may otherwise undermine these banks' improved incentives that come with the phasing out of directed lending and transfers of government deposits. These injections should therefore be closely monitored.

Prudential ratios are at comfortable levels, but it is hard to assess their adequacy, as it is uncertain to what extent these ratios are embedded in a proper risk-based framework and derived from independent supervisory analysis. The low level of non-performing loans should neither be a reason for complacency. Bad loans can increase rapidly as a result of the economic slowdown, borrowers' balance sheet mismatches, and higher lending rates. To better anticipate and absorb potential loan losses, we welcome the authorities' commitment to bring the existing loan classification and provisioning requirements in line with best practice standards.

We are pleased to see that certain structural actions are taken upfront. Besides modernizing the financial sector, these actions also increase the effectiveness of the authorities' stabilization efforts. Going forward, additional structural efforts are needed to liberalize the economy and increase room for private sector activity.

Without an acceleration of structural reforms, potential growth may turn out lower than is currently foreseen by staff. Previous high growth rates partly reflect state-directed credit that boosted investment as well as earnings from re-exporting cheap Russian oil. As the authorities are committed to refrain from approving any new directed lending programs and the price gap between oil imports and exports has diminished significantly, growth rates of 6-7 percent in 2011-12 might be hard to obtain. We would appreciate staff comments as regards the underpinnings of potential growth.

Risks to the program should not be underestimated. The authorities' track record under previous Fund surveillance has been mixed and the protracted negotiations to come to this program suggest there is room for improvement in the cooperation between the authorities and the Fund. The program also entails serious financial risks. Staff estimation of the financing gap for 2010 is based on a fairly strong recovery of FDI and debt inflows, which may fail to occur in the event of lagging structural reforms and continuing low appetite of foreign investors. We also note that foreign reserves remain quite low relative to imports and short-term debt, even with exceptional access, an up-tick in capital inflows and the absence of program slippages. To mitigate the risks for the Fund, we rather would have seen a larger role for alternative finance resources. In that regard, we would like to hear staff's latest views on whether the approval of this program will prompt additional finance from for example the World Bank.
Mr. Alazzaz submitted the following statement:

I thank the staff for the well-written paper and Mr. Kiekens and Mr. Prader for their helpful statement. Belarus' impressive growth performance over the past few years has been underpinned by high investments, prudent fiscal policies, and a favorable external environment. However, the recent overheating of the economy with rising inflation and a widening current account deficit, coupled with the shock to Belarus' terms of trade, the impact of the global financial crisis on capital inflows, and weaker prospects in trading partners, have weakened growth and strained the foreign exchange market.

The challenge now is to address the impact of the shocks and put the economy back on track. In this connection, a Stand-By Arrangement (SBA) would help Belarus implement its economic program, which rightly aims at limiting the deterioration in the external accounts and restoring confidence. To this end, the center piece of the program is a devaluation of the currency and the implementation of a new exchange rate regime that better reflects the structure of Belarus' trade and financing flows. However, devaluing the currency and changing the peg to a basket would increase inflationary pressures and could lead to a loss of confidence and to substantial capital outflows thus forcing an exit from the currency basket corridor. To help mitigate the risks, it is essential for the authorities to strengthen policies in line with the program. In this regard, the authorities deserve credit for reversing most of the announced public sector wage increases of October 2008 and for tightening monetary policy.

In addition to strengthening macroeconomic policies, the authorities are also rightly focused on advancing structural reform. In this regard, I welcome the efforts to strengthen the financial system in line with the recommendations of FSAP update. The large capital injection to state-owned banks and the new blanket deposit guarantee should enhance confidence in the banking system. Moreover, I am encouraged by the authorities' commitment to strengthen the role of the private sector.

In view of the authorities' commitment to the program, the prior actions taken, and the staff's assessment that the criteria for exceptional access have been met, I can support the proposed decision. However, in view of the size of the proposed financing and the risks detailed by the staff, extra vigilance is needed.

With these remarks, I wish the authorities success.

Mr. Yamaoka and Ms. Shinagawa submitted the following statement:

We thank the staff and management for their dedicated efforts toward reaching an agreement with the Belarusian authorities. We also thank the staff for their informative and well-focused papers and Mr. Kiekens and Mr. Prader for their helpful statement. We support the authorities' request for this program and would like to provide comments on the following:

Exchange Rate Policy

Against the background that the Belarusian ruble has been overvalued under the U.S. dollar peg, we commend the authorities for having implemented both the devaluation and the shift to the basket peg. Regarding the devaluation, according to the statement by Mr. Kiekens and Mr. Prader, Fund staff recommended a 20 percent devaluation, though the authorities had initially preferred to limit the devaluation to 10 percent. Could the staff explain why a 20 percent devaluation was needed, while the CGER analysis suggests that the currency was overvalued by 11-14 percent?

Monetary Policy

The National Bank of the Republic of Belarus (NBRB) has raised the policy rate at a rapid pace, since late last year, including this year's recent hike in early January. We basically agree to the tightening policy stance of the NBRB given that the current inflation rate is far above the NBRB's target of 11.5 percent. Still, we are concerned that, in the current economic situation, the rapid monetary tightening might cause a credit crunch. We welcome the staff's comments, if any.

Also, as the staff indicated in paragraph 18, at this moment, the primary purpose of monetary tightening is to deal with the rising inflationary trend, rather than to prevent capital outflows. With the economic outlook being quite gloomy and decreasing upward inflationary pressures, there will be a downside pressure on the inflation rate. Thus, if the main aim was to ease inflation, we wonder if the NBRB's stance was appropriate. We welcome the staff's comments, if any.

Financial Sector

While we concur with the required policies for the financial sector, concerns remain regarding some financial sector reforms, such as the tightening of loan classifications, the reduction in directed lending and the privatization of state banks, which may prevent funds from flowing to the private sector, at least in the short term. Comments from the staff are welcome regarding this point.

With these remarks, we wish the authorities every success in their future endeavors.

Mr. Moser and Mr. Weber submitted the following statement:

The rapid deterioration of the global economic environment, reflected in faltering export demand and a reversal of favorable energy price trends, has exposed significant weaknesses in Belarus' largely state-controlled economic model and now threatens to severely destabilize the economy. Both supply and demand factors have contributed to a domestic overheating in recent years, exacerbated by the limited reliability of price signals. The program offers Belarus not only financial support to cushion the crisis fallout but also an opportunity to start transitioning its economy in earnest. We note the authorities' commitment to the agreement as shown by significant upfront policy measures and support their program request. We also agree that Belarus meets the criteria for exceptional access.

First Objective

With regard to the first objective of the program, we agree with the proposed strategy for macroeconomic stabilization that entails a significant adjustment of Belarus' foreign exchange and fiscal policies, and in particular wage restraint. We note that the responsiveness of the current account to changes in the exchange rate is low (¶14). This is disturbing, given that a significant current account adjustment is key for the program to be fully financed. We suggest that staff closely monitor and report on the impact of the devaluation. This could include its effect on trade and domestic cost structures, taking into account the limited geographic diversification of exports and the contribution of crude oil processing to external revenues. The switch of the peg to a currency basket that includes the Russian ruble will add a further dimension to this assessment.

Second Objective

Belarus' situation suggests that this arrangement would not be successful in supporting a sustainable stabilization of the economy without the inclusion of structural measures. Such steps are necessary to bolster the program's second objective of reducing vulnerabilities. We are pleased to note that the program contains important structural measures. While these could have been more extensive, we consider their focused scope a consequence of the short duration of the program. If this arrangement serves as a stepping stone for further and deeper structural reforms, preferably in the context of an EFF as indicated, then the Fund's support seems well invested. How firm is the authorities intention to continue such a Fund relationship beyond the end of this SBA?

We welcome the authorities' intention, stated in Mr. Kiekens' and Mr. Prader's statement, to create a favorable investment and business climate, foster the development of the private sector, and create a level playing field for economic agents. The authorities should make substantial progress in liberalizing price and wage setting mechanisms and in improving the business climate, including by reducing red tape.

The findings of the 2004 FSAP and its recent update are particularly relevant as a roadmap for establishing a more crisis resilient financial system that serves the economy more efficiently. We welcome the fact that the government intends to bring the loan classification and provisioning requirements in line with best international practices, while also tightening them. Better data for supervisory purposes is needed and will allow for a much more reliable assessment of the soundness of banks. Like staff, we consider directed lending to enterprises through state banks particularly problematic. Phasing-out this quasi-fiscal practice will render the government's fiscal accounts much more meaningful. Strong emphasis should be given to banking sector reform in a successor program.

The social safety net in Belarus is extensive in terms of public expenditure volume, but to a large extent not targeted. We suggest that staff seek World Bank input to help the authorities optimize the design an not merely increase the transfer volume of the social protection system.

Financing

We hope that the Fund's engagement will be catalytic by way of restoring the volume of trade financing, fostering private capital inflows, and lengthening loan maturities. As uncertainty recedes, this should help cover the remaining financing gap in 2010. In our view, however, staff's projected rebound of FDI and of medium- and long-term loans is very optimistic. Significant access to capital markets seems unlikely until further structural reforms enhance Belarus' attractiveness to foreign investors. We are also less optimistic on further involvement of bilateral or multilateral donors. We would be interested in indications about such potential official financing, particularly from the World Bank and the EBRD.

Risks

We fully concur with staff that strict adherence to the arrangement is indispensable and that even small deviations would put the program at risk. Key risks are related to the resilience and credibility of the exchange rate anchor in a highly uncertain external environment. The recovery of the economy anticipated in the second half of 2009 could be delayed much as the latest indicators for the global economy suggest. As mentioned above, private external financing may also not be forthcoming as envisaged. The program remains very vague on possible measures if these risks should materialize. Could staff elaborate on the discussions with the authorities on contingencies?

With regard to the risks to the Fund's resources, the proposed access is large in terms of the debt service burden it generates. Belarus will have to be able to generate sufficient hard currency revenue through exports to service it. This underlines the need for enhancing the competitiveness of the economy and supports the case for the devaluation and for domestic measures that improve cost-efficiency and bring about real depreciation.

Finally, we note that in all recent exceptional access cases staff's assessment has pointed out that the Fund's burden sharing mechanism could be put under severe stress should the debtor country accrue arrears (i.e., should the program unravel). This clearly points to the need to revisit this mechanism in the context of the lending facilities review.

Mr. Fayolle submitted the following statement:

We thank the staff for a well-written paper. We are also grateful to Messrs. Kiekens and Prader for their clear and candid statement.

We support this Stand-By Arrangement for Belarus.

After years of strong growth and a recent period of overheating, the global economic slowdown has revealed the vulnerabilities that have been building up in Belarus, and that previous staff reports had underlined. With global demand decreasing in a context of worsening terms of trade, international reserves shrinking, and external financing drying up, Belarus now finds itself with large financing needs. As well described in the staff report, the level of required adjustment is too large to be achieved by monetary and fiscal policy contraction alone. We agree with the staff on the fact that exceptional access criteria have been met, and therefore support the request presented by the authorities for such an access. However, the largest part of the adjustment will have to come from a reduction in financing needs through the current account deficit. This highlights the crucial importance for the authorities to be strongly committed to a full implementation of the program.

In this regard, we welcome the wide-ranging set of prior actions, which provide an upfront support to the implementation of the program. In particular, the combination of a previous overvaluation of the real exchange rate, a long-lasting negative terms-of-trade shock and the slowdown in global demand did call for an adjustment of the currency. The peg to a basket, as opposed to a single currency, should provide more flexibility for the economy to adjust, while the relatively wide fluctuation margin will add another buffer. However, in light of the large currency depreciations that are taking place throughout the region, we would appreciate the staff's comments on whether a 20 percent devaluation would be enough.

Looking forward, it will be important that the exchange rate regime change be supported by an appropriate macroeconomic policy mix, in order to avoid an inflationary rebound that would erase competitiveness gains. This will be all the more important that the steps taken toward price liberalization should also have a long-term inflationary impact, through price level convergence.

We also welcome the measures geared toward enhancing the operation and stability of the banking sector. In particular, the suppression of directed lending is a welcome and much awaited step forward. We also fully back efforts to enhance the classification and provisioning of nonperforming loans, and concur with staff's call for strengthened supervision, especially as the central bank provides banks with uncollateralized support. The recent development of unhedged forex loans is a source of concern, and we would appreciate staff's comments on the underlying factors explaining such a build-up. What would be the risks associated with disorderly movements of the exchange rate in this regard?

Turning to the macroeconomic framework of the SBA, we concur with the need to tighten monetary and fiscal policy, as such measures are unavoidable in light of the required adjustment. The very high public investment level of the past years provides the authorities with some room for maneuver to contain public demand. Wage measures will be more painful, even though the safety net framework should contribute somewhat to alleviate their impact. The macroeconomic scenario foresees a rapid resumption of exports, as well as of FDI, but risks are high. We would appreciate staff's comments on the possible remedial actions, should these risks materialize.

The SBA should cover the financing needs for 2009, but more may be needed in 2010. In the current juncture, we support the design of the SBA, which focuses on the immediately, urgently needed reforms that will help the country weather the current crisis. We look forward to the success of the current arrangement, and to the continuation of a fruitful cooperation between the IMF and the authorities.

Mr. Mojarrad and Mr. Jbili submitted the following statement:

We thank staff for a concise and well written paper and Mr. Kiekens and Mr. Prader for their insightful statement. Following a period of rapid growth and declining inflation, the economy of Belarus was set back by a combination of adverse factors, including the large and permanent shift in the terms of trade, the unsustainable expansion in domestic demand, and the drying up of external financing in connection with the global financial crisis. We commend the authorities for putting together a program to address these challenges and for implementing all prior actions. We support the proposed Stand-By Arrangement, including the proposed exceptional access.

The proposed program is well calibrated to address the large current account deficits looming ahead, and the related financing needs. The combination of exchange rate adjustment, fiscal tightening, and wage restraint are potent remedies to deal with a permanent adverse terms-of-trade shock, and bring down domestic demand growth to a sustainable level. Inevitably, growth will decelerate significantly in 2009 and 2010, which would need to be offset in a timely manner by policies aimed at reviving growth. We note, however, that the envisaged structural reforms are somewhat backloaded, and some of them are relegated to a successor EFF, which may delay the supply response. Staff may wish to comment on the scope for a more ambitious structural reform agenda, and how to strengthen the supply response.

Exchange rate policy will be key to the success of the program, and we agree that the shift in the peg to a basket of currencies, with a wider band around the basket parity, is a sensible policy choice. Given the downside risks highlighted by staff in ¶35, it would be important for fiscal and monetary policies to provide much needed support. In this regard, we welcome the authorities' decision to raise interest rates by 4 percentage points, and the planned removal of the ceilings on interest rates charged on corporate loans.

On fiscal policy, we note that some of the adjustment measures apply to the whole public sector (¶12 of the MEFP), including wage restraint, the elimination of directed lending, and public sector investment. In fact, the contribution of public enterprises to the adjustment effort is relatively large, with the elimination of directed credit alone accounting for about 3 percentage points of GDP. While this is an important undertaking, given the large share of public enterprises in overall domestic investment and credit growth, it is not clear how the activities of public enterprises are to be monitored. We would appreciate staff indications if a consolidated financial situation of state-owned enterprises is available, and if other monitoring mechanisms are envisaged.

The financial sector reform agenda is geared toward maintaining financial stability and ensuring that banks operate in a market-based environment. We agree that the phasing out of directed lending, the elimination of interest ceilings on corporate loans, and the privatization of the large state-owned banks are key pillars of this program. We would appreciate staff clarification on the likely impact of the phasing out of directed lending on the balance sheet of state-owned banks, and whether further capital injections by the government into these banks will be accompanied by their restructuring. Also, we would be interested to know if the exchange rate devaluation would generate losses for state-owned banks and possible contingent liabilities for the central government.

With these remarks, we wish the authorities full success in their future endeavors.

Mr. Heath, Ms. Hull and Mr. Lin submitted the following statement:

We welcome Belarus' engagement with the IMF and its authorities' preliminary efforts to adjust policies in response to its domestic economic crisis. We also appreciate the staff's effort to reach agreement with the Government of Belarus on an appropriate policy response. We would have been pleased to see an economic reform program that addressed the root causes of the problem; unfortunately, we do not believe this program, as currently designed, is adequate to this task. The IMF has, for many years, warned of the impact of the Government's efforts to maintain extensive control over the Belarusian economy. Belarus' recent strong economic performance was driven, in large part, by favorable terms-of-trade developments transmitted to the economy through loose fiscal and wage policies. These conditions have been reversed with a move to more market-based pricing of energy imports, and appear unlikely to reemerge in coming years. This raises important questions about Belarus' growth prospects, as well as its ability to achieve the necessary balance of payments adjustment in a challenging international environment.

As we stated in the December 22 Executive Board briefing, we are skeptical that the proposed SBA will restore Belarus to a sustainable balance of payments position. The combination of Belarus' unsustainable expansionary macro policies in recent years, its peg to the dollar, along with reduction of Russian energy subsidies and reduced prospects for exports and capital inflows, have resulted in depletion of reserves and a large financing gap. Structural factors, including the government's extensive control over wages in the economy, are a primary cause of these imbalances; a commitment to avoid large wage increases in 2009 is important, but does little to ensure Belarus' competitiveness going forward. As noted in the staff paper on Assessment of Risks to the Fund, we believe that deep-seated structural issues must be tackled for Belarus to restore sustainable economic growth and balance of payments, and to meet its repayment obligations to the Fund. Moreover, the front-loaded schedule of disbursements does not provide strong incentives to follow through on policy commitments—the most critical shortcoming in the Belarusian administration's previous engagement with the Fund. While legislative mandates require the United States to oppose (abstain or vote no) any financial assistance to Belarus except for loans and assistance serving basic human needs, we wish to be recorded as voting no on the SBA because of our serious policy concerns with the proposed program.

Objectives of the Arrangement and Conditionality

We disagree with the characterization in Messrs. Kiekens and Prader's statement that the global financial crisis is the cause of Belarus' vulnerabilities. Belarus' economic difficulties have been developing for a long time and are driven by unsustainable macroeconomic policies and a foreseeable re-pricing of gas imports from Russia, rather than from the global financial crisis. In the 2007 Article IV consultation, the staff clearly warned that the real exchange rate was already overvalued by about 10 percent, and that expansionary macroeconomic policies would force Belarus off its exchange rate peg. They also underscored that early adjustment was required to accommodate expected increases in prices of Russian gas exports and argued for wide-ranging structural reforms to raise productivity and contain macroeconomic risks. As we noted in our preliminary statement, the lack of agreement by the authorities, with the thrust of the staff advice, caused us concern about an increasing risk of an economic crisis.

Despite strong growth in recent years, Belarus' failure to implement structural reforms and continued heavy involvement of the state in economic activity are undermining competitiveness. The staff report for the 2007 Article IV underscores that Belarus lags behind its peers in most structural reform indicators, and the request for the SBA notes that FDI inflows are much lower than other CIS countries, and EBRD transition scores are among the lowest. In this regard, we feel the assumptions on foreign investment in the balance of payments going forward may be overly optimistic or, at the very least, strongly contingent on further progress on structural reforms. In light of regional economic and financial conditions, including exchange rate developments, we question the staff's assumptions regarding export performance. It is particularly noteworthy that both the Ukrainian hryvnia and the Russian ruble have already depreciated in excess of 20 percent relative to the dollar in recent months. We would also appreciate comments from the staff on whether the assumptions underlying export projections factor in the effects of measures being undertaken by large trading partners to mitigate the domestic impact of the global economic slowdown.

More generally, we disagree with the staff's overall strategy for engagement with Belarus. The report notes that both the staff and the authorities agreed that additional structural reforms were needed to achieve medium-term growth but suggest a follow-on program can help achieve these goals. The staff paper makes valid points about timing concerns related to price liberalization and privatization in the current global economic environment, but this should not preclude Belarus from engaging the MDBs on plans and strategies that could be taken up in a phased manner, as conditions require and as circumstances permit. This could have been accommodated through a longer SBA including additional IMF-core structural measures, potentially in the latter part of the program. We appreciate the authorities' commitments on price liberalization and banking sector reforms, but believe these need to go further to ensure a positive outcome. We also welcome the authorities' letter which indicates their intent to pursue broad-based economic reforms in the not-too-distant future, but in light of past reversals we would like to have seen the program incorporate additional prior actions and other near-term commitments to implement those reforms.

Exceptional Access

The program provides very large loans and tilts the balance between financing and adjustment toward financing. The amount of 420 percent of quota over 15 months exceeds the current standard access limits and, on an annualized basis (335 percent), even the proposed limits of 200 percent per year. Exceptional access is generally intended for countries facing capital account crises, while Belarus' financing gap, as noted in the staff paper, is driven primarily by current account developments. In addition, exceptional access is intended to be accompanied by exceptionally strong policies, while the proposed program sets aside structural issues that are critical to achieving external sustainability, with the expectation that they would be addressed later. While the exceptional access policy provides flexibility to act on a case-by-case basis, we do not believe the authorities' policy commitments in this case are substantial enough to merit the proposed financing.

Safeguarding IMF resources

Given the results of the 2004 safeguards assessment, we attach very high priority to the updated review and identification of corrective measures as soon as possible. We would have strongly preferred that this reassessment be completed before any decision to disburse. A strong effort should be undertaken to put in place any corrective measures before further disbursements.

Mr. Horgan and Mr. St-Amant submitted the following statement:

We thank the staff for an informative set of papers and Mr. Kiekens and Mr. Prader for a helpful statement.

The Belarus economy is overheating, as is reflected in growing inflationary pressures. This internal imbalance is accompanied by a growing external imbalance, as shown by the sharp drop in international reserves, reflecting the authorities' interventions to defend an overvalued exchange rate (Box 1) and an increasing current account deficit. The economy now needs to adjust and the proposed program aims at bringing this through a mix of exchange rate adjustment, fiscal restraint, tighter wages, and structural reforms.

While we strongly support some of the proposed measures, we have reservations regarding others. We also have questions.

Measures We Strongly Support

We welcome the fact that the program addresses some structural issues that are critical to adjustment and the mitigation of vulnerabilities. The lifting of interest ceilings and the decision to progressively move toward more price flexibility, for instance, are steps in the right direction.

Also positive is the fact that budget policy has generally been prudent. The authorities are to be commended for this. We congratulate them, in particular, for their commitment to achieve a zero budget deficit in 2008/2009.

We also congratulate the authorities for their participation in the FSAP process and welcome their commitment to implementing various measures that will strengthen their financial system.

Our Reservations

While we welcome the steps taken toward a more competitive and flexible exchange rate, we would have preferred a more ambitious approach. There is considerable uncertainty about what would constitute an appropriate value for the currency, especially given the worsening global economic environment, and it is not clear that the depreciation and the new, wider (+/- 5 percent) band will prove sufficient. More flexibility would have facilitated the required adjustment and mitigated financial risk for the IMF. It may be that the institutions necessary to conduct an independent monetary policy are not yet in place in Belarus, but we would have liked to see, at least, a commitment to develop such institutions and to move toward more flexibility.

We see too much ambiguity about the nature of the monetary policy anchor in this program. While most of the text would suggest that the anchor is the exchange rate target, there are also references to an inflation target (that we find very high). It is hard to see how such a target could be reached, except by chance or through direct price controls (which we hope the authorities should move away from) given the exchange rate target.

The staff's document indicates that the authorities agreed that "were the global environment to prove worse-than-expected, they would need to take additional market-based measures to support the program's objectives." However, it is not clear what these measures would be. On the other hand, the document indicates that better conditions than expected would lead to a "less tight fiscal stance." Why this asymmetry? Why not identify measures that would need to be implemented if the global environment turns out to be worse than expected?

We note that some of the arguments used to justify exchange rate inflexibility in recent Fund programs (the presence of an exit strategy, large foreign currency exposures and contagion risk) appear less relevant in the present case.

Our most important reservation is that, at the moment, we see no clear exit strategy in case the proposed exchange rate regime could not be sustained. Such strategy would be very important given the risks attached to this program.

Other Considerations

We are surprised to see that exceptional access could be given in this case. As is indicated by the staff, Belarus faces mostly a current account problem, and it is not clear that this problem requires a very quick, and large injection of funds. Could the staff please comment on this?

There appears to be a financing gap left ($500 million), unless there is an EFF next year. We assume that that this means that supporting the present program would implicitly mean supporting an EFF that we have not seen. Could the staff please comment on this?

At the moment, other potential lenders seem reluctant to participate in this multilateral financing effort. Could the staff provide information on why this is?

We have not seen indications in the documents that there is broad-based support in Belarus for this program. Policies such as wage restraints, budgetary restraints, and high policy interest rates could prove unpopular. Could the staff please comment on the amount of support they perceive?

In sum, we see many positive elements in this program and welcome the authorities' commitment to reforms, but we also have reservations and questions. Our final decision will largely depend on whether we are satisfied that there is a good exit strategy. We are looking forward to any information the staff could provide on this at the Board meeting.

Mr. Mozhin and Mr. Tolstikov submitted the following statement:

We thank staff for well-written set of papers and Mr. Kiekens and Mr. Prader for their informative statement.

After the devaluation of the Belarusian ruble on January 2, 2009, typical reaction in the world business media outside the CIS has been like “Belarus: Global Turmoil Reaches Unreformed Economy.” Such negative connotations with regard to Belarus are common; however, the reality is much more complex. As noted in the staff report “despite lagging structural reforms, Belarus’ growth has been impressive.” Since 2002, average growth has been 9 percent and, owing to strong social policies, the poverty level in Belarus is among the lowest in the region, while good basic health and educational services are broadly available. Some explain such strong performance by implicit energy subsidies from Russia. However, we should acknowledge that among many CIS countries, which enjoyed energy prices below market levels, Belarus used this opportunity most efficiently, mostly for modernization and restructuring of its enterprises. As a result, productivity and competitiveness of Belarusian industries have improved substantially. At the same time, owing to prudent fiscal and monetary policies, Belarusian public debt and external debt ratios are among the lowest in the region. More surprisingly, assessing Belarusian business climate the last World Bank’s Doing Business report has qualified Belarus as “top reformer, globally and regionally.” Its Doing Business indicators have improved in 2008 and it is ranked substantially higher than all other European CIS countries.

Despite all its past achievements, Belarusian economy has been hit hard by global financial and economic crisis. Shrinking export markets due to sharp drop in demand in major trading partners, payment delays, problems with obtaining trade finance and freezing of credit lines for Belorussian banks by their western counterparts have put overwhelming burden on a small and very open economy. As U.S. dollar appreciated against the currencies of Belarus’ main trading partners, currency peg to the U.S. dollar came under pressure and foreign reserves started to decline.

The authorities’ efforts to improve the resilience of the economy after escalation of the global crisis in September 2008 should not be underestimated. They recapitalized banks, introduced new liquidity management instruments and provided liquidity to the banks, in order to keep the banking system working. They also introduced full guarantee of all households’ deposits. As a result, the public confidence in the banking system remains high. We note also their decision to raise key interest rates, tightening the monetary policy. Finally, they managed to secure financial support from Russia. However, taking into account the depth of external crisis, low level of reserves and the lack of available financing, a deep adjustment became unavoidable.

The large one-time devaluation of the ruble and the introduction of the new, more flexible exchange rate regime are central elements of the program. We welcome the new exchange rate regime, which better reflects the structure of the Belarus' trade and financing flows. However, the implementation of the new exchange rate policy is not without risks, as it depends on public confidence in the ability of the authorities to maintain new exchange rate level. Media sources reported about increased demand for imported durable goods in the first days of January 2009. The exchange rate realignment and interest rate increase were expected to discourage conversion of the ruble deposits into foreign currency, but there have been moderate withdrawal of ruble deposits. In this regard, the authorities should pay additional attention to their communication strategy in order to cope with rumors and panic.

To keep the exchange rate within the band over time, tight monetary and fiscal policies are indispensable. Therefore, the fiscal tightening measures were inevitable, including introduction of limits for public sector wage growth and restraining public investment spending. We find appropriate, however, the gradual approach to reduction of housing subsidies for population as the exchange rate shock, price growth and tight wage constraints makes this politically difficult. The social safety net should be strengthened at a time when the economy is contracting.

We broadly agree with the structural conditionality aimed at supporting the macroeconomic adjustment and improving efficiency of the Belarusian economy over the medium term. Elimination of the directed lending and interest rate ceilings should improve banks incentives to manage risks properly, which is important in a more unstable and tough economic environment. The realignment of the loan classification and provisional requirements in accordance with the international standards would improve transparency of the banking system. Privatization of state banks may also improve their efficiency. However, the current situation is not favorable for attracting potential investors. Therefore, we support a careful preparation for banks' privatization, envisaged in the program.

We note that the balance between financing and adjustment in the proposed program is quite heavily on the adjustment side. The program envisages drastic macroeconomic measures aimed at reducing domestic demand in order to restore external balance and most of them are implemented upfront, as prior actions, ahead of receiving the Fund's financing. This is quite testing for the Belarusian economy and people. We also note that staff estimates of financing gap may be on the optimistic side. Therefore, relatively small access limit under the SBA arrangement leave the program vulnerable to possible deterioration of external environment. We would welcome staff comments on the prospects for the additional World Bank budget support for Belarus.

We are pleased to see that the authorities have fully delivered on their promises—all prior actions have been implemented in time. We fully support the proposed Stand-By Arrangement.

With this remarks, we wish the authorities well.

Mr. Itam submitted the following statement:

We commend the Belarus authorities for the strong economic performance of the recent years, which was supported by prudent macroeconomic policies and a favorable external environment. However, we note that the ongoing economic and financial crisis has led to a significant negative current account shock which has generated considerable financing needs and that the situation is being exacerbated by the ongoing capital account pressures. We are in broad agreement with the thrust of the staff reports and support the authorities' request for exceptional access under the stand by arrangement.

We welcome the authorities' macroeconomic policies, which are geared mainly toward the countries ability to respond to external shocks and contain vulnerabilities. We support the envisaged reforms of the exchange rate regime to provide more scope for absorbing shocks and enhance competitiveness. However, we agree with staff that this should be carefully executed to prevent the loss of the nominal anchor advantages of the current exchange rate regime. We welcome the steps taken to correct for the estimated exchange rate misalignment and would appreciate staff comment on the degree to which this is expected to contribute to the reduction of the financing gap. Successful implementation of the exchange reforms would require supportive fiscal and monetary policies. In this regard we welcome the authorities' pronounced flexibility to adjust their fiscal program in the event of financing shortfalls.

Progress made in strengthening the financial sector framework for crisis management is encouraging. This is important for the country to be able to address potential financial sector risks. The introduction of the blanket deposit guarantee to prevent a run on deposits as well as measures that will allow for timely provision of liquidity to banks when needed are welcome. We support the authorities' intentions to phase out directed lending with the aim to facilitate financial sector competitiveness, enhance banks' risk management incentives and reduce their dependence on government.

The authorities plan to liberalize prices is the right step toward a more flexible economy. Enhancing the role of the private sector will also benefit medium term growth prospects and we welcome the authorities' efforts in this regard.

With these remarks, we wish the authorities well in their future endeavors.

Ms. Xafa and Mr. Spadafora submitted the following statement:

We thank staff for the well-focused report and Messrs. Kiekens and Prader for their frank and informative buff. The immediate priority for Belarus is to maintain stability in the face of a rapidly slowing global economy, facilitate external adjustment to shocks, and reduce vulnerabilities. We therefore support the proposed SBA, which addresses these concerns and also initiates significant structural reforms, mainly in the financial sector. However, like staff and some Board colleagues, we note that Belarus is still a transition economy clearly in need of profound reform, and we thus encourage the authorities to consider, in due course, a follow-up EFF to help further advance Belarus' structural transformation.

Exchange Rate Regime

Box 1 of the staff report suggests that the exchange rate is most likely overvalued by 11-20 percent, with the bulk of the evidence pointing to the lower end of this range. We note from

Messrs. Kiekens' and Prader's statement that the authorities agree that preserving external competitiveness is critical for addressing Belarus' balance of payments need. However, they saw wage moderation as a better means than a nominal exchange rate devaluation to preserve external competitiveness. As a result, the authorities cancelled their plans for a hefty public sector wage increase and have instead limited it to 5 percent in 2009, with private sector wages likely rising at a similar rate. In light of this development, the 20 percent devaluation that was implemented on January 1st does not take into account the wage restraint adopted by the government. The concern here is that, following such a large devaluation, inflation may be hard to restrain under more favorable cyclical conditions in the medium-term. Moreover, as reported by staff, the responsiveness of the current account to exchange rate adjustments is low due to Belarus' energy-heavy export basket. Finally, with the fluctuation band widening to +/-5 percent, monetary policy will have to play a significant supporting role for the new exchange rate regime, in a context of low financial sector development and lack of full central bank independence. Staff comments would be welcome.

Financial Sector

We strongly concur with staff that the new NBRB's uncollateralized lending facility should be used only as a last-resort instrument to address temporary liquidity difficulties, and must not end up supporting insolvent institutions. We welcome the authorities' recognition of the exceptional nature of such instrument, and their intention to strengthen the monitoring and supervision of banks using the new facility.

A shift toward a market-based financial system takes on a pivotal role within the overall strategy to reduce the country's vulnerabilities. We thus commend the authorities and staff for having included some of the major recommendations from the FSAP update into the SBA program. The phasing out of the government-directed lending programs is a cornerstone of this strategy, given their negative side-effects clearly spelled out by staff in ¶22. Such disengagement will also provide the bulk of the envisaged fiscal tightening, to the tune of 3 percent of GDP. We also welcome the structural benchmarks to support the strengthening of the financial system, notably the alignment of the loan classification and provisioning requirements with international standards.

We appreciate the authorities' commitment to strengthen their crisis management capabilities by formalizing the institutional framework through a Memorandum of Understanding that will help coordination and division of responsibilities among the various agencies. At the same time, like Messrs. Stein and Dahlaus, we note that the program does not address another major shortcoming of the regulatory and supervisory framework, namely the lack of full independence of the NBRB Board. While we acknowledge the authorities' view that the de facto degree of independence is sufficient, we note that the need to address this issue, first raised in the 2004 FSAP, has been included among the recommendations with the highest priority in the FSAP Update. Given the crucial importance that the authorities attach to financial sector development, we encourage them to make further progress, as the full independence of the regulatory agencies is a fundamental component of any strategy aimed at rebuilding the financial system on market-based principles. Staff comments are welcome

Mr. Nogueira Batista and Mrs. Joseph submitted the following statement:

We thank staff for the detailed report and Mr. Kiekens and Mr. Prader for their helpful statement.

Economic growth in Belarus has been robust this decade, underpinned by favorable terms of trade, energy subsidies from Russia and strong growth in trading partners. The fiscal accounts were prudently managed. In recent years, the central and general government balances have registered surpluses or small deficits, reflecting budgetary restraint as well as strong economic growth. Public sector debt is very low, only 6.6 percent of GDP at the end of 2008. The financial sector has some vulnerabilities, but by its very underdevelopment it faces fewer risks from unhedged foreign exchange borrowing and has less exposure to the global crisis than the financial sectors of many other countries in Eastern Europe. We remark in passing that, in present circumstances, an underdeveloped and relatively closed financial system may be a blessing, given the destructive potential demonstrated by financial sector growth and financial globalization in the ongoing crisis.

The vulnerability of Belarus' economy cannot be attributed, therefore, to fiscal or financial system vulnerabilities. The country's key weaknesses are to be found in its external accounts. The balance of payments deficit on current account rose to high levels in 2007 and 2008, reaching 6.8 percent and 7.6 percent of GDP respectively. International reserves were relatively low even before the onset of the crisis. In 2008, the confluence of several factors – the unwinding of Russian energy subsidies, falling energy prices, slower growth in trading partners' economies and reduced access to trade financing – exposed the vulnerability of the economy's external position. As a result, the currency came under increasing pressure and reserves were reduced to extremely low levels in defending the dollar peg.

The main objectives of the SBA—helping the economy adjust to the current external shocks, and secondly to reduce its vulnerability to adverse external developments—are appropriate. The strategy to achieve the first objective involves a devaluation of the currency, a change in the exchange rate regime and demand management measures. The devaluation was accompanied by a switch to a currency basket peg that more correctly reflects the economy's trading partners. The authorities will of course have to adequately communicate this strategy to the population in order to help build confidence in the new regime and mitigate a rush to acquire safer foreign financial assets that would put additional pressure on the balance of payments. The demand management measures include a tight fiscal stance that involves wage restraint and reductions in public investment and subsidies. If the reduction in directed lending programs is considered, the withdrawal of state support to the economy amounts to about 3 percent of GDP, according to staff. Traditionally, the state has been the principal driver of economic activity, and we are concerned that the proposed fiscal adjustment may be too sharp. In this regard, we are reassured somewhat by the strengthening of the social safety net and the inclusion of an adjustor that would accommodate additional external financing, if it becomes available. We also welcome the strengthening of the framework for crisis management, the capital injection to state-owned banks and the other proposed measures to strengthen the financial sector, as outlined in the Memorandum of Economic and Financial Policies.

The move to an exchange rate regime based on a currency basket with a wider band will protect the external position. The current account deficit is expected to fall from US$ 4.5 billion in 2008 to US$ 3.1 billion in 2009. The program also targets significant reserve accumulation. However, the current account deficit will still be high in 2009, despite the devaluation of the currency and the sharp slowdown in real GDP growth. The financing of this deficit does not seem entirely assured, given the country's limited sources of external financial support. Russia is the only source of bilateral support. Staff informs us that the World Bank and the European Union are not prepared to make firm commitments at this stage, even if the Executive Board approves the Stand-By Arrangement.

The program that is being presented to the Board may well prove to be underfinanced. The amount of resources provided by the Fund could have been higher. We were informed in the last Board meeting on Belarus that the authorities had hoped for more. Indeed, the proposed stand-by for Belarus is smaller, relative to the country's quota and GDP, than almost all arrangements recently approved by the Board. We recall that Belarus has no outstanding debt to the Fund. The country's external debt is low and public debt is negligible.

The authorities have embarked on a substantial reform of the economy. It is unfortunate that this economic transformation is being undertaken at a time of deteriorating domestic and external circumstances. The authorities' immediate challenge is macroeconomic stability, although other important structural reforms are necessary to ensure long-term sustainability. We take note, however, of the fact that Belarus' economic growth has been very high, close to 9 percent on average since 2002, despite lagging structural reforms. As pointed out by the authorities, the implementation of these reforms, such as price and wages liberalization, should have a medium-term time line. In this regard, we welcome plans to increase private sector activity, open the economy to FDI and improve the business climate, which would be needed to fill the vacuum created by the government's reduced participation in the economy.

With these remarks, we support the request by Belarus for a Stand-By Arrangement, and wish the authorities success in their endeavors.

Extending his earlier remarks, Mr. Nogueira Batista noted the authorities' commitment to further raise interest rates swiftly to defend the exchange rate band, if needed. While the staff report stated that banks were not especially vulnerable to a currency devaluation, they were vulnerable to a deterioration in credit quality due to the economic slowdown and higher interest rates. There seemed to be a contradiction in that regard. Banking sector vulnerability to interest rate increases and macroeconomic slowdown could pose important constraints to using the interest rate to defend the exchange rate band.

The staff representative from the European Department (Mr. Kähkönen), in response to Executive Directors' questions and comments, made the following statement:

> I will begin by giving Directors an update on economic developments since the issuance of the staff statement. Thereafter, I will answer some of the questions that were raised on the exchange rate regime, on a possible successor arrangement, and on the political economy of the program; Mr. Mates will answer questions on monetary policy and fiscal issues, structural reform, and relations with the World Bank and donors; Mr. Arvanitis will address the issues that Directors have raised on Exceptional Access Policy; finally, Mr. Prokopenko will answer questions on banking issues. There were many questions of a more technical nature that we have tried to answer bilaterally prior to this meeting; therefore, the focus here will be on addressing the main themes.
>
> First, allow me to provide an update on the current economic situation. The staff statement provided information on reserves through January 6th and banking data through January 8th. Subsequently, there have been some further shifts from local currency to foreign currency deposits. Over the entire period since the devaluation, local currency deposits have declined by some 8.5 percent, although total deposits, including those in foreign currencies, have declined by only 1.5 percent.
>
> As of this morning gross international reserves were a bit less than $100 million below their level at the end of 2008. However, there is a three-day settlement period, which means that interventions enter into the reserves data with a three-day lag. We understand that intervention from the beginning of the year has amounted to more than $300 million, so we would expect the reserves data to show some further decline in the coming days.
>
> What does this all mean? Admittedly, the realignment and shift to a new regime has not yet restored stability, although the pressures at foreign exchange offices have reportedly dissipated somewhat over the weekend and today. Staff expects stabilization in the period ahead,

particularly when approval of the IMF program is announced. This is a view that the authorities share.

Discussion of these recent developments leads logically to some other questions that Directors asked on the exchange rate regime. Is the devaluation too large, or is it not large enough? What are the risks of speculation or dollarization? What is the exit strategy? Let me take these in turn.

Some Directors wondered whether the devaluation was sufficient given the currency depreciations taking place throughout the region. The staff's assessment of exchange rate misalignment takes into account all the devaluations that have taken place across the region as of last month. The Russian ruble has depreciated further since Belarus' devaluation, but the inclusion of the Russian ruble in the new currency basket reduces the impact on Belarus.

There was also a question on why a 20 percent devaluation was needed to correct for an estimated overvaluation of 11-14 percent. The 20 percent is a nominal devaluation, and the 11-14 percent assessment is a real overvaluation. The staff's estimates of the pass-through from the nominal exchange rate to prices suggest that this 20 percent nominal devaluation does correct the real overvaluation of 11-14 percent.

There were also questions on the risks of a speculative attack. The Belarusian ruble is not widely traded internationally, and capital account flows are subject to restrictions. Staff thus considers the likelihood of a speculative attack to be quite remote, especially as the state-owned banks that dominate the banking sector would not cooperate in this endeavor.

Dollarization is a risk, as evidenced by the events of the past few days. However, the authorities believe that the Fund's approval of the program will provide an important boost to the public's confidence in their policies. The increases in interest rates that the authorities have enacted also increased the incentives for the public to continue holding domestic currency deposits. That said, should pressures to convert money into foreign exchange persist, the authorities will need to respond aggressively by raising interest rates further in line with the program commitments.

As to the exit strategy, the program is designed to be so strong as not to give rise to persistent pressures on the currency, and the staff expects that the program will work. However, if the pressures continue, the program has a variety of safeguards. It envisages consultations with the staff on additional measures, including the full use of the exchange rate band and additional tightening of monetary targets and fiscal policy through automatic adjusters built into the program. The wage increase for May 2009 is also conditional on overall macroeconomic conditions. Finally, the program has a consultation clause tied to the level of gross reserves that will ensure early corrective actions. This is all beyond the normal features of Fund programs; namely, an assessment—and, as needed, reassessment—of the policy framework at the time of quarterly reviews. Over the longer term, Belarus's low external and public debt provide a fairly stable base if there is a need to move to a more flexible exchange rate arrangement, and for that there is a need to build more capacity to implement monetary policy based on inflation targeting.

Finally, in the area of exchange rate policy, staff was asked to comment on intervention operations under the new basket and band. The staff's advice has three elements in this area. First, intervention should be conducted in a way that does not undermine the credibility of the new band. In particular, smoothing the ruble/dollar rate that the public once focused on under the old peg might be tempting, but doing so would risk undermining the credibility of the new basket arrangement. In this regard, it is reassuring that the authorities so far have allowed more volatility in their ruble/dollar rate while keeping the basket value unchanged.

The second element of the staff's advice regarding intervention is that in the period immediately following the devaluation, some intramarginal intervention to help stabilize expectations is helpful. It would not be helpful in a situation where there are still some expectations for further devaluation in the population to have the currency slide immediately within the band.

Third, more generally, the staff has advised the authorities to be guided in their intervention strategy by the Net International Reserves (NIR) targets under the program, and they also have been advised to consult with the staff on corrective actions if the level of reserves declines below the thresholds identified in the program.

Some Directors asked whether, in light of the financing gap for 2010, supporting the current program implies also supporting unseen a successor EFF. They also asked about what policies the authorities were contemplating for such an EFF. From a program standpoint, there is no financing gap since the period covered by the program, namely this calendar year, is fully financed. The financing gap arises beyond the program period in 2010. Accordingly, the Board will have every opportunity to weigh in on any future program and make its decision to approve that program on its own merits. Staff has not had discussions with the authorities related to an EFF, but such discussions could be expected to focus on addressing longer term structural challenges, as the authorities have already indicated in the Letter of Intent.

Finally, let me turn to some questions on political economy. Directors inquired about efforts to build consensus in favor of wide-ranging economic policy changes and the amount of support staff perceived for such measures, especially given their potential unpopularity and the associated political risks. The public's response to the discussions and the final agreement on the program has in general been positive, although immediately after the devaluation there were some expressions of surprise and anger among the public. There have also been some encouraging signs of the authorities' commitment to the program. The President has been quite frank with the public on the economic difficulties facing the country and the need to undertake difficult adjustment. He has also spoken favorably about staff's arguments for various measures envisaged under the program. The authorities' capacity to implement the program also seems to be strong, as we have seen from the very strong prior actions, including on the wage and the budget fronts in the past month. These tough measures appear to have been accepted by the public. That said, maintaining public confidence will be essential for the success of the program. This means that clear and consistent communication and policy implementation will be very important in the period ahead.

Another staff representative from the European Department (Mr. Mates), in response to Executive Directors' questions and comments, made the following statement:

Staff has been asked to comment on whether the large devaluation could stoke inflation over the medium term. Indeed, such a risk would be high if the devaluation were to trigger a wage-inflation spiral. However, one of the peculiarities of this program is the very tight wage policy, imposed on 80 percent of workers across the entire economy. The government has committed to limiting wage growth to 5 percent in nominal terms in 2009, and it does have instruments to deliver on this commitment. This would lead to around a 2 percent decrease in domestic demand in 2009. The combination of tight labor and demand policies should facilitate controlling the inflationary spike created by the devaluation.

Another Director asked whether the recent increase in the interest rates would cause a credit crunch. The recent interest rate increases have been motivated primarily by the aim to stabilize the balance of payments and strengthen demand for ruble deposits. The quantitative targets under the program still imply growth in private sector credit of about 13 percent at the end of 2009, which does not suggest a credit crunch. Moreover, the program is designed in a such a way that, should the balance of payments situation improve more than envisaged, there would be more scope for credit growth.

During the today's discussion, a question was raised on what to do if there is a pressure on the balance of payments and there is an alternative between increasing interest rates or letting the exchange rate go down further. A point waw made that according to Box 2 in the assessment by the FSAP team, banks would perhaps be less sensitive to exchange rate adjustment than to interest rate increase, but this is obviously only one consideration. If as a result of further pressures in the balance of payments, the authorities let the exchange rate depreciate even more, there would be several other negative effects including on inflation and also on the overall confidence in the program. For example, further inflation could indeed derail the wage program, as it would be difficult to expect that the 5 percent limit on nominal wage growth could in such circumstance be preserved. Therefore, the choice between whether to let the exchange depreciate further or increase interest rates should be based on similar broader considerations, not only the immediate effect on the banking sector.

On the fiscal policy, there was a question about the fiscal risk created by the bank recapitalization and by the treatment of these recapitalization expenses under the program. Following the very large recapitalization at the end of 2008, neither the staff nor the authorities expect further recapitalization to be needed in 2009, which is stated in the Memorandum on Economic and Financial Policies. Hence, the fiscal risk in that regard is limited, while the proposed treatment under the fiscal performance criteria is similar to that used recently in other Fund programs.

A related question concerned the possible use of recapitalization resources for further expansion of directed lending. First, I would note that the liquidity effects of the recapitalization will be fully sterilized by a reduction in central bank credit to banks; otherwise, the Net Domestic Assets ceiling of the central bank under the program would be breached. The recapitalization will not only provide a cushion against future losses, but it will also improve banks' liquidity indicators. These indicators have deteriorated over the last few years when credit growth was extremely fast, often close to 50 percent, and banks to a large extent were refinanced by the central bank by using very short-term facilities. This deterioration probably was not noticed by depositors, but it was certainly noticed by foreign partners, and the weak liquidity ratios of these banks could indeed then affect possible access to foreign financing, which is anyway at risk.

Regarding the concern about using these resources for directed lending, the authorities have eliminated the possibility for the government to place budget deposits with commercial banks, which has been the main instrument of providing funding for directed lending to this point. The government has also committed to cease all directed lending operations until they are fully transferred to the budget. Therefore, in general, we do not see the risk that the recapitalization resources would be used for further directed lending.

There was another question on fiscal policy related to the symmetry of adjusting the fiscal target in the case of insufficient financing versus situation in which the government might obtain additional resources. As stipulated in the Technical Memorandum of Understanding, the relevant adjuster works both ways; indeed, if the government does not receive some of the foreign lending envisaged under the program, there will be a need to tighten the fiscal target for the following quarter. In practice, this could apply only to the absence of financing from the Russian authorities because this loan is part of the financial program, in which case some tightening of the fiscal target under the program would be necessary.

Staff was also asked to comment on the scope for a more ambitious structural reform agenda. The program introduces several measures to achieve progress in this area. First, there are measures to reduce red tape, e.g. price controls, and excessive government interference in already privatized companies in which the government has retained minority shareholding position. The implementation of the latter measure will require the revision of many legislative acts and should eventually have far-reaching effects in terms of liberalizing the Belarus economy. Currently, even companies in which the government has only a very limited shareholding position are subject to extensive reporting requirements and numerous regulations that usually apply only to state-owned companies. This program envisages the elimination and revision of the numerous laws that are related to this practice. I would also like to note the reforms that have taken place with respect to the tax system. The government has decided to halve the turnover tax, and to completely eliminate this tax in 2010. Also, the local sales taxes, which vary across the country and apply different rates to imported and domestic goods, will be unified. This would substantially simplify the tax system. Finally, the government has decided to introduce a flat income tax rate as of this year. All these measures have not been included in the conditionality under the program because the government has decided on them a long time ago, before discussions on the program began. Nevertheless, these measures represent important steps toward modernizing Belarus' tax system, which should be viewed in the context of the broader effort to improve the business climate and implement structural reforms.

We have also been encouraged by the authorities' efforts to open two of the remaining four state-owned banks to foreign investment, having already privatized some seven or eight smaller banks in 2007-08. The efforts to open these two banks to foreign investment have for the time being been put on hold because the potential investors have asked for a time out, but the conditionality under the program provides for steps that will make the partial privatization of these two state-owned banks possible as soon as the overall global situation improves. This would complement the effort to eliminate directed lending as the removal of such operations from the state-owned banks would make them more attractive to foreign investors. Needless to say, faster privatization in general is crucial for strengthening structural reforms and improving the supply-side response in Belarus. The staff has found the authorities open to discussing this issue, although admittedly they have not yet formulated a sufficiently ambitious and comprehensive privatization program. Staff has therefore encouraged the authorities to start discussions with the World Bank and the EBRD, the two international financial institutions that have a primary role in this area, and we expect that progress will be achieved in this regard. Given that the agenda still has to be developed, we did not consider it appropriate to introduce specific conditionality in the program at this stage.

A related question arose on whether staff might be overly optimistic in projecting a potential growth rate of about 6-7 percent for 2011-2012. Belarus has, over the last 5-6 years, had a very high rate of investment of more than 30 percent of GDP. A large chunk of that investment went into improving infrastructure, which is in general in a relatively better shape than elsewhere in the region. Belarus also has a skilled labor force, and once the country opens to foreign investment and liberalizes its economy, we think there are good prospects for fast technological progress and overall growth. Staff therefore considers the projected potential growth rates realistic, assuming that structural reforms are implemented.

Finally, Directors asked about the potential role of other donors. Staff's impression is that potential donors are waiting on the Fund arrangement and possibly successful completion of the first or second review. Once this is done, we expect that other donors would move with much larger assistance to Belarus than is currently the case. We know that the World Bank is in discussions with the authorities on the structural reforms needed to ensure rapid and sustained recovery from the current global crisis as well as mitigating the social impacts of this crisis. However, the World Bank's Country Assistance Strategy does not envisage budget support for Belarus in the current period. The World Bank has not started revising the CAS. The EBRD and the EU Commission are in a similar situation.

The staff representative from the Strategy and Policy Review Department (Mr. Arvanitis) responded to Directors' questions on the Exceptional Access Policy. He noted that the Exceptional Access Policy was designed with capital account crisis in mind. However, the Board had decided that all requests for exceptional access were subject to the procedural requirements of the exceptional access framework. There was an important distinction that differentiated capital account from non-capital account crises. In capital account crises, all four substantive exceptional access criteria need to be met. In non-capital account crises, exceptional access was assessed in light of those four criteria, but the Board had the flexibility to grant exceptional access on a case-by-case basis. In the case of Belarus, the decision to provide 418 percent of quota was based on the size of the financing need, the strength of the program, and Belarus's capacity to repay the Fund.

The staff representative from the Monetary and Capital Markets Department (Mr. Prokopenko) in response to Executive Directors' questions and comments, made the following statement:

> I would like to answer questions on financial sector issues. Initially, however, I would like to thank the Directors for their statements, which supported the analysis and recommendations of the Financial Sector Stability Assessment (FSSA) update, and endorsed the position of the staff on financial sector issues in the proposed Stand-By Arrangement. I will focus my remarks on three issues raised by Directors—systemic stability, banking supervision, and the prospects of credit growth to the private sector.
>
> On systemic stability, there was a question on the extent to which banks will be affected by any further deterioration in the external and domestic environments and what then will be the recapitalization need through the budget. Our stress test results show that banks can withstand significant shocks maintaining the capital ratios above the prudential minimum. This is the case because baseline aggregate capital adequacy is relatively high. Moreover, the overall depth of bank intermediation in Belarus is relatively low by regional standards; total assets of the banking sector are equal to only 50 percent of GDP. So, as Mr. Mates mentioned moments ago, we do not expect any need for the government to recapitalize banks in the near future. Even if such a need arises, the amount of recapitalization will be rather limited.
>
> There was a question on the risk of a deterioration in foreign currency denominated loans in the case of disorderly movements of the exchange rate. Foreign currency loans in Belarus account for only around one-third of total loans, which is a relatively small share compared to that in many other Eastern European countries. Moreover, the majority of these loans in Belarus are issued to the export-oriented enterprises. As a result, the indirect effects of exchange rate depreciation on loan quality are expected to be relatively limited. Appendix IV of the FSSA provides more details on this.
>
> Turning to the policy framework, staff was asked to comment on the supervisory capacity of the National Bank. The Basel Core

Principle Assessment conducted in the context of the FSAP update showed a significant improvement of banking supervision since the original assessment in 2004. However, there are still several important issues that compromise the effectiveness of banking supervision, including government-directed lending that distorts supervisory analysis, a loan classification and provisioning regime that departs from best international practices in several aspects, and the independence of banking supervision.

On this point of independence, there was a question on why strengthening the independence of the national banks has not been included in the list of program conditionality despite having been classified in the FSSA as a high priority issue. This issue of independence is not in the Stand-By Arrangement for two reasons. First, the authorities disagreed with the FSAP team, noting that in practice the National Bank operates independently, and this is mentioned on page 43 of the FSSA in the paragraph on the views of the authorities on the Basel core principle assessment. As such, insisting on inclusion of this issue in the conditionality would have undermined ownership and might have been counterproductive.

Second, our main concern with the insufficient independence of the National Bank relates to the capacity of the National Bank to implement effective supervision over state-owned banks that are engaged in directed lending. This issue should become less critical when banks stop their engagement in these directed lending programs, which is actually a conditionality under the proposed program.

Finally, there was a question whether some financial sector reforms, such as the tightening of loan classification or the reduction in directed lending, may prevent funds from flowing to the private sector. In our view, proper classification rules will reveal a more appropriate level of nonperforming loans and more accurately convey the condition of banks, which should in turn strengthen confidence in banking sector and facilitate banks' access to funding. Therefore, we do not think that this would impede private sector credit growth.

On directed lending, such lending in the past might have in some cases crowded out market-based lending to viable enterprises, preventing both banking and corporate sector restructuring. Thus, discontinuation of such lending and gradual carving out the stock of these loans from bank assets should stimulate effective credit risk assessment and management in banks and result in sounder and sustainable lending to the private sector.

Mr. Heath made the following statement:

Our written statement explains our reasons for opposing this program, and I wanted to elaborate and clarify a couple of points out of respect for colleagues. U.S. law requires that this chair be directed to at least abstain from support. This law requires that an audit of military spending be provided to civilian authorities in the country, and this requirement is not met. The law has a second aspect related to free, fair, and transparent elections and human rights requirements, and again these conditions are not being met. Thus, we are required to abstain at least from this decision. That said, this chair is dissenting from this program, and we do that not, in a sense, as representatives of the United States, but really as officers of the Fund and members of the Board in view of our concern for the credibility of the Fund and its negotiating with subsequent countries. We said in our statement that we certainly welcome Belarus' engagement with the IMF and staff's good work in reaching agreement with them on appropriate policy responses. We join many colleagues in welcoming this level of engagement and hope for such increased engagement in the future and a move toward the policy measures that the Belarus authorities indicate they are interested in pursuing. We also note, however, that this is a short-term, stopgap type of program with no real requirements for Belarus to continue on that positive path.

Belarus' economic difficulties have been developing over a very long time, and they are driven by unsustainable macro policies rather than from problems associated strictly with the global financial crisis. You will recall that in the 2007 Article IV consultation and documents before that, the staff had clearly warned about the real exchange rate overvaluation, the problems incipient with the exchange rate peg, the problems with the pricing of Russian gas, and the staff has consistently argued for wide ranging reforms to raise productivity and contain macroeconomic risks. These have been largely ignored. We would have been pleased to see a program that really addressed the root causes of the problem, but we do not believe this program is up to the task. There is always hope that, yes, Belarus will get on this path, but we are at a loss to explain why such things are not included in this program. We are not looking for a wholesale change in the economy, just the macro critical structural changes that normally are part of a package like this.

In this context, we find ourselves disagreeing with the staff's strategy for engagement with Belarus. It appears our complaint is not with the Belarusian authorities, they have certainly indicated that additional structural reforms are needed to achieve medium-term growth, and the documents are replete with examples, so we support their intention to pursue these broad-based economic reforms. We are left with a mystery as to why the staff did not suggest some way of incorporating these measures into a normal package, and that would certainly even justify exceptional access much more robustly than is done here. The Belarusian authorities seem to agree with what we all recognize as needed for a real solution to their economic problems. This causes some question. I am aware of a 1995 letter that agreed to, or spoke favorably about, the same things we are discussing now, only they did not happen. It may be appropriate that in some of the descriptions of the authorities' intentions in the staff paper, like in paragraph 23 on directed lending, there is some question about how quickly these things will be implemented. There is a need for a phase-in, but there is no real discussion of a timeline. I can understand that this would depend on conditions and political support for the package. I think it is certainly admirable to take the authorities' good intentions at their word and to encourage their best intentions, and so we look forward to some positive result. However, we are at a loss to explain why we could not be doing a longer Stand-By Arrangement that would include these additional core structural measures potentially in the latter part of the program, and that would certainly have helped to address these concerns. I recall in our first session about Belarus the French Alternate Executive Director asked why are we not doing a program that actually stretches the time of the financing gap beyond 2010, and we joined in that query about why we are not doing a longer program and one that does include those structural changes that we find so critical and so important to the longer-term economic future of the country.

My concern about this for the IMF will end with a question, too. Is the Belarus approach to become our model? Is this the way other countries are going to be offered something vaguely in the future about the conditions that we know now are required for the positive result?

Mr. Moser noted that the additional $300 million loss of reserves seemed relatively high in comparison to program targets, suggesting that the trigger for the consultation clause in terms of gross international reserves was approaching. In that light, he asked staff to elaborate on the strategy going forward. He also indicated that he was impressed with what staff had achieved on directed lending given how important this had been for the Belarusian economy. That said, he wondered why staff had opted for a structural benchmark on refraining from new directed lending rather than a continuous performance criteria.

Mr. Nogueira Batista made the following statement:

> I would like to thank staff for their replies. I think there is one issue that was brought up by Mr. Vogel, which I had brought up in the previous meeting on Belarus, and I think we should come back to; namely, the comparison between the way Belarus is being treated with the way Latvia was treated. I insist on that point because the Fund will have to carefully communicate to the outside world why the exchange rate regime change is such a crucial condition in the case of Belarus, but in Latvia there is this strenuous attempt to finance the defense of a currency that by Fund calculations, if I am not mistaken, is more overvalued than the Belarus currency. I took note of the reply that you gave me in the last meeting. I would like you to elaborate a little bit more thinking about the fact that the Fund will have to explain this different approach to the public at large.
>
> My other question concerns staff's analysis of the economy of Belarus and the context in which this crisis has arisen, because this is not due to fiscal factors. In fact, Belarus' fiscal numbers were quite good over recent years, with surpluses in the overall result of the public sector in several years. Debt has been declining over time, and public debt is negligible. Thus, it is not a fiscal problem. It is not a financial sector problem, either. Belarus has a very underdeveloped and closed financial sector compared to its neighbors. By the way, as we mentioned in our statement, we should note that in present circumstances having an underdeveloped and closed financial system is a real blessing. In any case, it is not a financial sector problem. It may become a financial sector problem if you try to defend the exchange rate band with dramatic increases in interest rates, but it is not a financial sector problem right now. It is a balance of payments problem. The current account deficit increased quite sharply in the last two calendar years, 2007-08, to about 7-8 percent if I recall correctly, and as you note in your report the level of reserves in recent years was

low. As such, the country was vulnerable to a balance of payments crisis because of these weaknesses.

Why am I recapitulating this? I wanted to ask you whether you think the program is really strong enough for facing these issues. I noticed that despite the devaluation of 20 percent and despite the very sharp slowdown in growth from 2008-2009, the current account remains high. Why? Here I am referring to the dollar current account and not to the ratio of the current account to the GDP, as I assume that you are calculating this with current exchange rates, so the devaluation would tend to increase this ratio.

Secondly, I would like to come back to the issue of the level of reserves. I understand that the program targets a substantial increase in reserves, and at first sight this looks quite important, but when you look at the way that NIR targets are defined, you see that there is not much room for intervention. Hence, it appear that you are giving reserves to the country but also saying you cannot use them. How much of this $2.5 billion will be available for intervention if needed? I recall that I was quite surprised to read in your report that there is no visible immediate catalytic role from this agreement—i.e., even if the Board approves the program today, and I expect it will, the World Bank and the European Union are not ready to take on firm commitments with respect to financing. The only bilateral source of financing is Russia. So, if I understand correctly, there is not much room for intervention and no catalytic role to speak of, so it seems we are depending on the seal of approval effect from the supposed strength of the program. Is that so?

I recall that Mr. Prader in a previous meeting on Belarus had told us that the authorities hoped for more financing from the Fund. I notice that Belarus' program has 419 percent of quota compared to 1,000 percent of quota for Hungary, 1200 percent of quota for Iceland, 1200 percent of quota for Latvia, 800 percent of quota for Ukraine, and 500 percent of quota for Pakistan. As a percent of GDP, is it that the quota is large in Belarus relative to GDP? No, because in percentage of GDP the program is also lower than all other programs recently approved. So, is the program underfinanced? Could more funds have been provided to make the program more resilient, i.e. less dependent on adjustment, on using interest rates to defend the peg, and so forth? These are the issues that I would like to raise.

Ms. Xafa understood from the staff's response that the estimated 11-14 percent overvaluation assessment was based on the real exchange rate, whereas the 20 percent devaluation that took place on January 1st was a nominal devaluation vis-à-vis the US dollar, which was expected to be eroded to some extent by the pass-through of higher import prices. The 11-14 percent overvaluation range was based on an expected wage increase in 2009 that would not materialize, as the authorities had scaled down wage growth to just 5 percent from the initial plan of 40 percent. A concern in that regard was inflation because the economy was very open and imports were two-thirds of GDP. The other concern was the broadening of the exchange rate band to plus/minus 5 percent. Hence, with a widening of the band, monetary policy would need to play a significant supporting role in the new exchange rate regime. She therefore wondered if the authorities would have the capacity to implement open market operations, and whether the interest rate channel of monetary policy transmission worked well in Belarus.

Mr. El-Khouri shared Ms. Xafa's concern that interest rates were bearing an undue burden in supporting the exchange rate regime. He noted Mr. Moser's observation that the consultation clause might take effect soon, and wondered how the Board discussion would initiate in that circumstance given that the Fund had no resident representative in Belarus to closely monitor developments. The staff was asked whether any substantive discussions had occurred between Belarus and the World Bank on financial support from the Bank.

Mr. St-Amant noted that his Chair still had some concerns on the program, and looked forward to the staff's responses to earlier questions raised on reserves and the level of financing. That said, his authorities supported the program, as it included enough positive elements and implied sufficient progress to merit support.

Mr. Mozhin invited the staff to elaborate on what it saw as the secrets of Belarus' economic success over the past two decades. He noted the country's reputation as a clean, cheap, and safe place with almost no income or wealth inequality. This success could not be solely explained by Russian gas subsidies. For example, one might look at the success of other similarly small, open economies that were internally relatively centralized, e.g., Singapore or Slovenia.

Mr. Warjiyo made the following statement:

> First, coming back to the issue of the exchange rate vis-à-vis the interest rate, I understand the interest rate will need to be one of the policy measures to be taken, but I also share the concern raised by previous speakers on the effectiveness of the transmission mechanism of interest rate in restraining the domestic demand due to a number of

reasons. The interest rate was just recently liberated by eliminating the cap on the lending rates, do I do not presume that will work. Also the banking is dominated by directed lending, which is again suggests that the credit channel will not be effective in transmitting the interest rate policy in restraining the domestic demand. As such, I also wish to raise concern on the effectiveness of this policy in stabilizing the balance of payments going forward. I believe there are much more effective policy measures, which I also noted from Mr. Prader's statement, for demand pressure mitigation and other sort of fiscal measures at this juncture.

Second, on the fiscal measures, I see that there will be a reduction on the directed lending program, which will limit public investment going forward. How will this impact growth? Could the impact on growth be mitigated through an increase in the private investment?

Mr. Bakker made the following statement:

I am very grateful to staff for the answers. As noted in my statement, we do support the program, but at the same time it was a difficult judgment call for my authorities, partly because the track record under IMF surveillance has not been very satisfactory. The Fund's advice over the past years does not seem to have been followed through. This issue might have been analyzed more thoroughly in the staff paper, including the apparent disconnect between the Fund's advice and the actual economic progress in Belarus. Although my feeling is that a stronger policy framework over the past few years might have helped to avoid—or mitigate—the impact of recent developments, what we see is that the economy is extremely vulnerable for external influences. In that sense, Belarus might, after all, not be such a great success story, but I would be interested in hearing staff views in that regard. The reason we can go along with this program is the comfort we take from the prior actions, our sense that this is possibly a stopgap program, and our sense that this program might provide the basis for longer-term structural reforms needed to transform the economy and make it more flexible and capable of dealing with external vulnerabilities. In that respect, we feel that the impact the IMF program can have in increasing transparency and accountability will be very helpful, including with respect to public institutions and finance. I think that is crucial for an effective monitoring of the program and safeguarding resources, but also more generally for socioeconomic success in Belarus.

I have two questions and one comment. I would like to support Mr. Warjiyo in his remarks on the need for monetary policy to be supportive of the exchange rate regime. Secondly, staff referred to the announcement effects of this program that might help to stabilize the situation, which of course has been quite unstable over the past few days because the exchange rate change came as a large shock. Given that the IMF program was announced more than two weeks ago, I wonder about the impact of today's announcement. Are there new elements that have not yet transpired in the public debate in Belarus?

My comment is on the safeguards assessment. Mr. Heath has asked for its speedy completion, which I would support. I would be interested in hearing from staff when that will be finalized. Thank you.

The staff representative from the European Department (Mr. Kähkönen), in further response to Executive Directors' questions and comments, made the following additional statement:

There was a question of what is the strategy going forward, given that apparently reserves have come down by over $300 million since the devaluation, even though the reported numbers will reflect this with a lag. We are not at the consultation trigger level quite yet, in part because the year 2008 ended with reserves about $250 million higher than had been expected. If reserve losses continue, the trigger point would approach and certainly the staff is in constant daily touch with the authorities, and the next step would be a further increase in interest rates to help stabilize the situation.

On the comparison between Belarus and Latvia, there are differences in the circumstances of the two countries that would suggest that different approaches would work in these cases. One, devaluation in Latvia would create very large balance sheet effects. In Latvia, 70 percent of bank deposits and 90 percent of loans are denominated in foreign currency. In Belarus, the balance sheet effects, as also confirmed by the FSAP update, are smaller, only a bit more than one-third of deposits are in foreign currency; banks net open positions are small; their share of foreign currency-denominated loans is small; and the majority of these loans are by export-oriented companies which have a natural hedge. In the Latvia program, there is

> a clear exit strategy; namely, adoption of the euro. Belarus does not have that exit option. Also in the case of Latvia, the authorities have strong support from the EU to defend the peg. One final thing, in the case of Latvia, regional spillover risks are a factor much more than in the case of Belarus.

Mr. Nogueira Batista noted the argument that currency devaluation would have large balance sheet effects in Latvia, but the alternative was an extremely harsh macroeconomic contraction and reduction in nominal wages, which would also have large balance sheet effects. It was debatable if these balance sheet effects might not be more severe than those arising from devaluation. Moreover, given that the current account deficit and overvaluation estimates were considerably larger for Latvia, that might not be a prima facie argument for devaluation.

The staff representative from the European Department (Mr. Kähkönen), in further response to Executive Directors' questions and comments, made the following additional statement:

> I think the facts you mentioned are correct. What matters ultimately is what can be financed, and in the case of Belarus there are very strict constraints on what can be financed, which requires limiting the current account to a fairly low level.
>
> On a related note, there was a question relating to whether it is a problem that the current account deficit remains fairly high in Belarus. The staff estimates that a sustainable current account deficit for Belarus is around 4 percent of GDP, and that is what the program projects for the medium term. It is no surprise that a fairly rapidly growing and still developing country like Belarus has equilibrium current account deficits at this point, and the staff's estimate is that about 4 percent is sustainable when the crisis is over.
>
> On the Fund's catalytic role, one explanation why other institutions are not providing additional financing right now is that Belarus has been fairly isolated from the international financial community until recently, and it takes time for the World Bank, the European Commission, and the EBRD to get up to speed and an increase in their assistance. The World Bank has a Country Assistance Strategy. There was a mission in December that overlapped in part with the IMF mission, and the World Bank started discussions on the structural issues, but it takes time to build the dialogue. Certainly, if the authorities have a successful program with the IMF, there is little

doubt that the catalytic effect will become visible, but there is a lag given the lack of engagement until recently.

With respect to the secrets of the Belarusian model, I think Mr. Mates will have something to say in that regard. For my part, I had not visited Belarus prior to the negotiations on this program, and I must say that I was struck by the same things that Mr. Mozhin mentioned. It is a very clean and safe country with good infrastructure. The issue of what are the pros and cons of that kind of model is probably something that is best left for an Article IV consultation discussion. I should mention that just before the crisis broke out, there was an Article IV mission, but obviously the higher priority has been to initiate this program. I imagine that in the context of the first review of the program there will also be an Article IV discussion, and I think these kind of broader issues will certainly need to be covered in that context.

On the announcement effect, clearly the agreement on the program was announced earlier, but the population has gotten at times inconsistent information, so seeing that the money is actually at the central bank will be an additional factor. The positive statements from the Fund including from management should actually have a further impact more so than in some other countries.

The staff representative from the European Department (Mr. Mates), in further response to Executive Directors' questions and comments, made the following additional statement:

There was a question on why we do not project a sharper adjustment in the current account given the sizable devaluation plus the contraction in domestic demand. It is because the terms of trade will go pretty much sharply against Belarus in 2009. When oil prices go down and oil product prices go down, the implicit value of the Russian subsidies also goes down. Belarus is losing substantial amount of export receipts from the oil products, and the overall terms of trade change is hitting the country pretty sharply in 2009.

There was a question on whether Belarus has open market instruments for effective open market policy. Technically these instruments do exist, and I do not think there is any problem in the absence of instruments as such.

How strong is the channel from the interest rates to the capital flows? In this particular context, the main capital flow is actually purchases of foreign currency by population. I have to admit that this is a pretty open question, indeed, because to some extent the pressure in the foreign exchange market in Belarus reflects regional developments. At first there were unfavorable developments in Ukraine, and then to some extent also the relatively persistent depreciation of the Russian ruble, both affecting expectations in Belarus. What we now see in the foreign exchange market, particularly in the segment of population, reflects to a large extent regional developments. This might reduce the effectiveness of the interest rate instrument but, on the other hand, that is the only instrument that is left for this purpose, so if the current trend continues, the interest rates will need to be tightened further.

On the secret of growth, the Russian implicit subsidies certainly have played a substantial role. On the other hand, the truth is also that the authorities have used these subsidies to increase the level of investment, which, as mentioned, has led to improvement in infrastructure. With the benefit of hindsight, one could argue that, instead of increasing investment, these implicit subsidies could have been used to beef up reserves. Indeed, over several Article IV cycles, staff has recommended strongly to increase the official reserves. It is interesting how in the beginning of these discussions the authorities always did not pay much attention to this recommendation, which perhaps reflected a high degree of confidence, in a sense that they can control all developments in the economy, as well the relatively good economic performance over the years. It was only maybe a year and a half ago that the authorities, when facing changes in the trade regime with Russia, realized that a substantially higher level of reserves was needed, which led in 2007 to a few large privatization moves. They sold pipeline and telephone companies, among other relatively large privatization projects, which allowed them to increase reserves substantially, from something like $1.7 million at that time.

With regard to the growth story, one aspect, as I said, is certainly investment. The second is the absence of the social displacement and disorganization that took place in many countries in the region during the process of transition. I would also note that many business people, who do business there, agree that, while there is the problem of red tape, corruption is drastically lower than elsewhere in the region. There is also a well educated labor force and bureaucracy.

> Moreover, the bureaucracy believes in what it is doing. I have not seen much cynicism over the 3 years that I have been visiting this country.
>
> The country certainly has to reform. This is going to be a gradual and cooperative process and can only be achieved after confidence has been built. One of the reasons why the authorities have not announced the agreement on the program is because they were waiting for the Board to finally decide. Certainly, the agenda in terms of structural change is huge, but there is a good chance that this program will actually start moving these reforms.

Mr. Heath wondered if there had been any discussion on longer-term issues or on a longer-term Stand-By Arrangement. If not, then why not?

The staff representative from the European Department (Mr. Kähkönen) replied that the broad program strategy had been discussed in earlier meetings, including the exceptional access meeting. The immediate crisis needed to be addressed, so in the shortrun the program focused on dealing with macroeconomic stabilization. While the staff had already detailed some immediately relevant structural measures, the authorities would need some time to work with international financial institutions to develop a broader structural reform agenda that would be a basis for a longer-term Fund program.

Mr. Heath asked for confirmation that the staff had not suggested to the authorities anything other than a short-term stabilization program.

The staff representative from the European Department (Mr. Kähkönen) said that the staff had proposed a two-stage program strategy with the relatively short Stand-By Arrangement to be followed by a longer-term structural program. As stated explicitly in the Letter of Intent, the authorities had endorsed this approach.

The Acting Chair (Mr. Kato) added that the staff and management had judged that it would be in the Fund's interest to pursue an SBA possibly followed by an EFF arrangement. In that way, it would be possible to continue a meaningful dialogue with the Belarusian authorities, which would help ensure achievement of the Fund's overall objective.

The staff representative from the European Department (Mr. Kähkönen) noted that there was also a question about the safeguards assessment. The authorities had provided the staff key information needed for the safeguards assessment, including the financial statements for 2006-07. The staff would hold discussions with the central bank's external auditors shortly with a view to concluding the assessment by the time of the first review.

Messrs El-Khouri and Nogueira Batista asked what proportion of the financing being provided by the IMF would actually be available for the purpose of intervention.

The staff representative from the European Department (Mr. Kähkönen) responded that about $400 million was available for the purpose of intervention in the first quarter, which partly reflected the higher than expected starting point for reserves at the beginning of the year. The quarterly targets were fixed and declined over time given the expectation of a decreased need as the situation stabilized.

Mr. Prader made the following concluding statement:

> First of all, I express gratitude on behalf of the Belarusian authorities, to management for proposing this program and also to staff for their hard work, in particular, Mr. Kahkonen and Mr. Mates for alternately leading missions to Belarus under challenging circumstances.
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> The program negotiations were difficult not only for the authorities but also for the staff. There is one point that I would like to make first, Mr. Mates, who today so well explained the factors behind the success of Belarus is unfortunately going to leave the Fund in February. This is because he is one of the casualties of the Fund's misplaced and unfortunate downsizing. As you can see, when we lose staff members like him, who know so much about countries, we lose a lot as a result.
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> Mr. Mates rightly pointed out that with this program Belarus will be able to start a major reform process. Unfortunately, one Director opposed this program. However, I think this Director was wrong for the simple reason that this is the best opportunity for the reform of the economy and it should have been supported. It would have been strange if the Board had not supported this program because it is an important window of opportunity for the country, partly based on a dramatic change of economic circumstances and partly because the leadership of the country has also realized that they have to open up more and that they were hoping to get support from the international community. By supporting this program today, the Board has made a real contribution to this change.

It is very important to understand the complex negotiations that went into this program. What has been achieved today is really the maximum of what was possible, given the time available and the circumstances. And most of all, as Mr. Mozhin pointed out, the layers of misunderstandings, this discrepancy between the Fund always criticizing the country and the fact that the country was doing economically so well, that it had average growth rates of 9 percent and that for all those living in the country it was a success story. It is difficult for the authorities to undertake drastic changes and be criticized by the IMF year after year, when the country actually made a dramatic improvement in its living standards and also in comparison with other CIS countries. It was difficult to disentangle all of this. We must give credit to Mr. Mates and Mr. Kahkonen for being able to achieve something despite these difficult circumstances.

I very much appreciate the comments and recommendations of my colleagues. I can assure them that many of the comments that they made in their gray statements and today mirrored the arguments that the authorities also made in the negotiations. But small countries know that in the end, they have to accept reality. Of course, some can say that Belarus did not get a softer program but would it be possible for a small country to assume that somebody will help them to get a soft program? This program that we have before us is the best you can get in terms of a strong program. In this regard, some chairs have rightly pointed out that the balance is tilted towards adjustment and that the Fund's financing contribution is rather small. Undoubtedly, this is a really tough program. The combination of devaluation and wage restraint plus fiscal adjustment is impressive. However, as I see it from the debates in Western Europe, even if there is political support, it is difficult to avoid reform and adjustment. And, most often we see that small countries are better in making adjustment than larger countries, even if it is very painful.

This program is an opportunity for the Fund to demonstrate that it is nonpolitical, that it recognizes the difference in circumstances and institutions in the economic management of its member countries, and the Fund has made good use of this opportunity. I am grateful to all Directors who have judged the program on the basis of the merits of the adjustment and the economic intentions, rather than on the basis of an analysis of the heterogeneous system of the Belarusian economy or for that matter the political system of the country. I do not believe the U.S. chair will always oppose a program for Belarus. I am quite confident that by the time of the first review, they will understand that this was an important step towards liberalization and opening of the economy. One can always be open minded. I also appreciate the fact that Mr. St-Amant (Canada) could finally accept the staff's explanations with respect to the exchange rate and support this program.

With regard to the issue of the program ownership, on Friday, the President publicly commented about the devaluation of the currency. Although he said that the Fund had imposed conditions, including devaluation, he made it very clear that the country was in distress and would have had to do it anyway. Therefore, the authorities now support this approach and are behind it.

Finally two more points. First, on structural change. Because we could not complete the 2008 Article consultation in the Board, many Board members perhaps did not realize that in the last two years a number of structural changes had taken place. When I talked to the foreign banks in Belarus, they mentioned that in the last two years enormous changes had occurred, e.g. privatizations of telecommunication companies, scrapping of the golden rule on state control of firms, and the permission of greater ownership of companies. So while there were many changes taking place during the last two years, the current situation has really caught the authorities on the wrong foot. It was difficult for them to accept that the dramatic changes in external circumstances are irreversible and that they have to take some painful decisions. This is also why it took so long for them to accept certain policy measures that the staff was recommending.

As explained at length today, there are risks, but to the extent that you can have risk control, we have done everything that we have in the arsenal of the Fund to control the risk. But there can be of course other risks, like developments in neighboring countries, which will have an impact on the exchange rate. Nevertheless, and this is my last point, the most important thing is to have close contact between the staff and the authorities on the next steps because one never knows what will happen. It will be important that we work closely together. Thank you very much.

The Acting Chair (Mr. Kato) made the following summing up:

Executive Directors observed that Belarus faces a difficult economic situation due to the interaction of trade and financial shocks with underlying vulnerabilities. The authorities' program—supported by a 15-month Stand-By Arrangement under the Fund's exceptional access policy—combines exchange rate adjustment, fiscal adjustment, and tight wage policies to bring about a reduction in the current account deficit, while the move to a more robust exchange rate regime supported by the targeted reserve accumulation and the shift toward a market-based financial system will help address underlying vulnerabilities. Directors broadly endorsed the authorities' strategy, and stressed that rigorous implementation of the macroeconomic program and resolute pursuit of reforms to reduce structural weaknesses and vulnerabilities will be crucial for restoring external stability and achieving sustainable economic growth.

Directors considered that the realignment of the exchange rate—together with the authorities' actions towards wage restraint—will help restore competitiveness and address external imbalances, while the shift to a more robust exchange rate framework will make it easier for Belarus to adapt to external shocks. The authorities should monitor closely the impact of the exchange rate adjustment on the external position and on inflationary pressures, particularly in the context of the present economic uncertainties and the limited responsiveness observed in Belarus's current account to changes in the exchange rate. Directors stressed that, if faced with additional shocks, the authorities should be prepared to use the full range of flexibility provided by the wider exchange rate band, in order to ensure adherence to the planned path of reserve accumulation. While concurring that the exchange rate should continue to serve as a nominal anchor for the present, a few Directors saw scope for greater exchange rate flexibility in the medium-term in view of the openness of the Belarus economy and the continuing uncertainty in the external environment.

Directors underlined that the exchange rate adjustment will need to be supported by strong monetary and fiscal policies. They commended the authorities for the recent increases in interest rates, and called upon the National Bank of the Republic of Belarus (NBRB) to be prepared to raise interest rates further if the new regime comes under pressure.

Directors welcomed the authorities' commitment to maintain a tight fiscal policy to bring demand into line with external financing constraints. Following through on the commitments to maintain a central government budget balance and a prudent wage policy in the broader public sector through 2009 will be critical to the success of the program. Directors noted that Belarus has a strong tradition of social protection, but suggested that more may need to be done to protect the most vulnerable groups against the economic downturn. They were encouraged by the authorities' plans to review the social safety net in cooperation with the World Bank.

Directors underscored the importance of financial sector reform, and called on the authorities to follow closely the recommendations made in the FSAP update. Directed lending by the government should be brought under the budget, and flows of resources from the government to banks for directed lending should be terminated. Moreover, directed lending by the NBRB should be phased out. Directors also encouraged the NBRB to strengthen the frameworks for financial sector liquidity and solvency support. They welcomed the recent approval of a blanket deposit guarantee, and suggested that any ex-post liquidity provision via uncollateralized lending be accompanied by heightened supervision. The classification of and provisioning for non-performing loans should be brought in line with international best practice.

Directors expressed concern about the limited progress made in structural reform. They considered that a broad program of reform to enhance the private sector—involving reduction in the size of government, deregulation, and privatization—will be necessary to underpin stronger medium-term growth, and should be undertaken as rapidly as market conditions allow. They called on the authorities to move more expeditiously on price and wage liberalization. Structural reforms can make a key contribution in enhancing investor confidence and fostering FDI flows. In light of this, a few Directors, while recognizing the need for sequencing, would have preferred the inclusion, from the outset, of more ambitious structural reforms in the authorities' program.

Directors were reassured by the measures already taken by the authorities, but stressed that full and strict program implementation will be necessary for success. In view of the considerable downside risks to the program, they welcomed the authorities' willingness to take any needed contingent measures. Directors also expected that the catalytic role of Fund support would facilitate renewed access by Belarus to private sector and donor financing, thereby also serving to reduce risks to the Fund. Many Directors underscored the importance of a successful achievement of the objectives of the authorities' program to establish the basis for a more ambitious structural reform effort with IMF support.

The Executive Board took the following decision, with one objection by Mr. Heath (UA):

Republic of Belarus—Stand-By Arrangement

1. The Republic of Belarus has requested a Stand-By Arrangement in an amount equivalent to SDR 1,618.118 million for a period from January 12, 2009 through April 11, 2010.

2. The Fund approves the Stand-By Arrangement for the Republic of Belarus set forth in EBS/09/1 and decides that purchases may be made under the arrangement, on the condition that the information provided by the Republic of Belarus on the implementation of the measures specified as prior actions in Table 3 of the Memorandum of Economic and Financial Policies attached to the letter from the Prime Minister of the Republic of Belarus and the Governor of the National Bank of the Republic of Belarus dated December 31, 2008 is accurate and on the additional condition that the information provided by the Republic of Belarus on the devaluation of the Belarusian rubel against the U.S. dollar by 20 percent is accurate.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).
(EBS/09/1, 1/5/09)

Decision No. 14238-(09/3), adopted
January 12, 2009

APPROVAL: April 6, 2009

SHAILENDRA J. ANJARIA
Secretary