PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: PIDA119211

Project Name	Belarus MSME Access to Finance Project (P152276)
Region	EUROPE AND CENTRAL ASIA
Country	Belarus
Financing Instrument	Investment Project Financing
Project ID	P152276
Borrower(s)	Development Bank of the Republic of Belarus
Implementing Agency	Development Bank of the Republic of Belarus
Environmental Category	B-Partial Assessment
Date PID Prepared/Updated	07-Aug-2017
Date PID Approved/Disclosed	05-Aug-2016
Estimated Date of Board Approval	28-Sep-2017
Appraisal Review Decision (from Decision Note)	
Other Decision	

I. Project Context

Country Context

In recent years, unfavorable external environment overshadowed economic activity in Belarus, but significant progress was made on macroeconomic stabilization. Recession in Russia and low commodity prices have had a major downward impact on Belarus's economy which contracted by 3.8 percent in 2015, the first recession in two decades. This is largely explained by Belarus's dependency on the Russian market and on mineral exports . Real gross domestic product (GDP) continued to contract in 2016, albeit at a slower pace, by 2.6 percent y/y, due to lower export revenues and weak domestic demand. In addition, a dispute with Russia on the price of natural gas imports resulted in a 25 percent reduction in crude oil supplied by Russia to Belarusian refineries. In the face of difficult external conditions and domestic structural rigidities, a considerable reduction in aggregate expenditures has occurred. The magnitude of the adjustment is visible in the decline in the current account deficit from US$5.2 billion in 2014 to US$1.7 billion (about 3.6 percent of GDP) in 2016, mainly due to compression of imports. This adjustment was accompanied by tighter fiscal and monetary policies during 2015-2016. In particular, capital expenditures and real wages in the public sector have been reduced dramatically. In 2016, broad money supply decreased in real terms, while credit supply shrank by 10 percent in real terms. The economy has started stabilizing in Q1 2017, with mild and yet tentative recovery supported by growth in agriculture and manufacturing sectors.

Sectoral and Institutional Context

The financial system is marked by a high degree of government involvement and is dominated by banks. The majority of the financial sector comprises commercial banks, which constitute about 84

percent of assets, equivalent to 73 percent of GDP. The remainder of the assets is shared among the Development Bank of the Republic of Belarus (DBRB, 7 percent), the insurance sector (3 percent), and leasing and microcredit companies (slightly more than 5 percent). Within the banking sector, the largest 10 banks make up most of the banking system. Of these, the top five as well as two foreign banks are part of conglomerates. Nearly 65 percent of total assets are state owned and foreign banks account for 34 percent, while domestic private banks account for only 1 percent. For the system as a whole, lending to state owned enterprises (SOEs) made up 35 percent of banking assets at end-2015, while claims on SOEs were 57 percent of all banks' claims on the corporate sector. Individual state-owned banks have accumulated higher exposure to SOEs over time partly due to government programs aimed at developing certain economic sectors, such as woodworking or agricultural machinery, for which lending has been frequently subsidized at rates well below the market.

The Belarusian banking sector lacks depth and makes only a relatively small contribution to private sector development. With a post-crisis private sector loan-to-GDP ratio of 21.2 percent in 2016 (compared to 44 percent in 2010), financial intermediation in Belarus remains significantly below both the Europe and Central Asian average of 96.2 percent and the upper-middle-income country average of 112.1 percent.

Micro, Small and Medium Enterprises (MSMEs) are particularly constrained, especially with regards to loan tenor. While access to finance is an important factor for enterprise growth, it has become increasingly difficult for private enterprises to obtain funding in the aftermath of the crisis. The banking system channels a disproportionately large part of directed and subsidized credit to SOEs hampering efficient capital allocation while crowding out private sector banking development at the expense of market-based lending. Overall credit growth to corporates and households has fallen sharply in both national and foreign currency terms since 2013 and turned negative at a constant exchange rate during 2015. In a survey conducted by the WB in 2013, 19 percent of private enterprises identified lack of access to finance as the single most important obstacle to their growth (up from around 6 percent in 2008), which is relatively high compared to other countries in the region. In addition, only one-third of enterprises surveyed reportedly have a loan, which is significantly lower than the regional average of 42.5 percent. MSMEs in particular find it difficult to obtain affordable financing and are five times more likely than large enterprises to identify access to finance as the biggest obstacle for growth. MSMEs' source of financing for investment and operations is largely limited to their own funds. From 2008 to 2013, the proportion of MSMEs that financed their investments from internal sources rose from 65 percent to 78 percent.

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In support of MSMEs, DBRB aims to scale up its wholesale financing operations to maximize its development impact while sustainably scaling up lending to private enterprises through wholesale channels. DBRB, created in 2011 to centralize state-directed lending, has become a sizeable institution. The bank, which does not take private deposits and obtains funding mainly from the issuance of government-guaranteed debt, has grown rapidly to become the third-largest financial institution by assets. It acquired assets originated by two state-owned commercial banks under directed lending programs and is now responsible for about one-third of new directed lending. DBRB also acts as an agent for resolving NPLs for the Ministry of Finance (MoF). In 2014, DBRB initiated activities focused on addressing the medium- and long-term funding gaps of MSMEs and enhancing the effectiveness of directed lending. Going forward, DBRB plans to combine the management of directed lending with more traditional development banking functions, to enhance transparency and efficiency in the allocation of government resources and foster market-based wholesale finance for the private sector. The planned scaling up of wholesale financing will complement and catalyze the activities of commercial banks. With DBRB playing a growing role in the financial sector, further reforms are required to strengthen DBRB's mandate, governance and business model arrangements.

II. Proposed Development Objective(s)

The Project Development Objective (PDO) is to improve access to finance for private MSMEs and enhance governance and the institutional capacity of the Development Bank of the Republic of Belarus.

III. Project Description

Component Name
Component 1: Line of Credit to MSMEs
Comments (optional)

Component Name
Component 2: Institutional Strengthening of DBRB
Comments (optional)

Component Name
Component 3: Project Management and Implementation
Comments (optional)

IV. Financing (in USD Million)

Total Project Cost:	60.00	Total Bank Financing:	60.00
Financing Gap:	0.00		

Financing Source	**Amount**
Borrower	0.00
International Bank for Reconstruction and Development	60.00
Total	60.00

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V. Implementation

The project will be implemented by a Project Implementation Unit (PIU) housed at DBRB. The PIU will be established staffed with qualified personnel, capable of satisfactorily implementing all aspects of the project. Its responsibilities will include: (i) selection of and on-lending to PFIs; (ii) monitoring of PFIs to ensure compliance with project criteria; (iii) responsibility for adherence to all fiduciary and safeguard requirements of the WB for final borrowers; and (iv) M&E based on key indicators.

VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	**Yes**	**No**
Environmental Assessment OP/BP 4.01	X	
Natural Habitats OP/BP 4.04		X
Forests OP/BP 4.36		X

Pest Management OP 4.09		X
Physical Cultural Resources OP/BP 4.11		X
Indigenous Peoples OP/BP 4.10		X
Involuntary Resettlement OP/BP 4.12		X
Safety of Dams OP/BP 4.37		X
Projects on International Waterways OP/BP 7.50		X
Projects in Disputed Areas OP/BP 7.60		X

VII. Contact point

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