

Analytical note:
Monitoring of the situation in
the field of economic security
of Belarus
(March 2016)

The risk of financial instability

The most discussed event of the month was the decision of the authorities to gradually increase the retirement age by 3 years. This is due to the unfavorable demographic situation and general deterioration of the economy. Thanks to the measures to be taken until 2023, it is planned to maintain the current ratio between the workers and pensioners. Nominal reduction of pensions (which is even less acceptable for the authorities) or increase of the budget deficit (which contradicts to the current economic policy of the Government) could be an alternative. The speed of such a painful decision, which should demonstrate the readiness of the authorities to take the unpopular measures, may be associated with the negotiations on credit accommodation from the Eurasian Fund for Stabilization and Development (EFSD) and the IMF. And if the agreement with the first one was finally achieved, the actor will still continue the negotiations in early April.

Upon signing the 2 billion dollar credit program with the EFSD and receipt of its first tranche of USD 500 million the sovereign default risks sharply declined. The beginning of the program will not only directly support the considerably impoverished gold and foreign currency reserves (hereinafter referred to as the gold reserves), but will also assist in attracting resources from other sources. Thus, the news about the agreement with the EFSD had a positive impact on quotations of the Belarusian Eurobonds, and the current yield on them has fallen to the level of 6.5-7% per annum. The acceptable economic and political conditions allow the authorities to seriously count on new placement, which according to the plans may amount to USD 1 billion. Although the EFSD refrained from making public a detailed complex of measures accompanying the same loan of 2011, the Fund has outlined its principles quite clearly. Thus, the Belarusian authorities commit themselves to ensuring the macroeconomic stability and market reforms aimed at improving the economic efficiency. The list of measures is virtually identical to the requirements of the IMF and apparently differs only in the emphasis and implementation terms. This, of course, increases the chances of reaching an agreement with the Fund in the nearest future. Thus, the list of obligations of the Belarusian Government upon request of the EFSD includes as follows: reduction of directed lending, gradual reduction of cross-subsidization, severe limiting of growth of the public sector employees' revenues, reduction of inflation, reduction of the balance of payments deficit, and even stimulation of the privatization process.

The willingness of the Government to continue reforming the economy is supported by a number of programs and other legislative acts, adopted in March and early April. The key of them is the program of socio-economic development of the country for the next 5 years. Similar programs have been adopted since 1996 and have always been confined to the important electoral campaigns (presidential elections and the 1996 referendum). This time, the document stands out not only due to its adoption terms, but also due to its content: instead of a traditional list of target gross parameters (such as GDP growth, exports and incomes of the population), it contains key principles of the economic policy (macroeconomic balance, growth of the country's gold reserves and repayment of state debt at the cost of internal sources), as well as the blocks of institutional measures, aimed at ensuring the economic growth.

In March, the decision previously announced by the Government was finally accepted. The decision provides for tightening the rules for obtaining the state support. It

is expected that it will continue to be allocated only to the relevant government priority investment purposes and only on a competitive basis. The financing of the current activity of enterprises on the state account is not planned (however except for the agriculture). The progressive conditions will allow the Belarusian enterprises enter overseas markets with a transfer of a portion of shares (not more than 25%) to the foreign organizations.

The Government's decision to intensify the process of accession to the WTO is certainly positive news. For a long time the attention was paid to this process residually, while Alexander Lukashenko has repeatedly spoken with skepticism about the need for such an accession. However, the WTO membership of Russia and Kazakhstan, as well as the task of reducing foreign dependence on Russia (which implies a growing share of trade with the EU) essentially leaves no other choice.

The current policy of the authorities is also tough enough: implementation of the budget is substantially based on the level of surplus (3.1% of the GDP in January-February), the ruble money supply even to the level of January 2015 decreased by 10%, the growth of balances on credit in the economy is close to zero. The promised reduction in the cost of housing and utility services for the population was also insignificant, with the result that the rate of state compensation increased from 29.5% in 2015 to 40%.

The risk of economic recession

The reverse side of the restrictive fiscal and monetary policy is the ongoing economic downturn. Thus, the decline in GDP in January-February amounted to 4% and the industry and construction are still under influence of this process (minus 5.6% and minus 25.2%, respectively). The authorities continue hoping to move to the positive economic dynamics starting from the second half of 2016. Such an outcome is supported by the exhaustion of a high base statistical effect of the first half of 2015 (the economic downturn in 2015 gradually accelerated from 0.6% in February to 4% in August) and the improved dynamics in the main foreign markets. Thus, in February, the economic growth in the amount of 1% of GDP was seen in Ukraine, the increased economic activity in the second quarter of 2016 is forecasted by the Russian authorities. At the same time we still cannot talk about the imminent transition of the Belarusian economy to a growth mode. Even the optimistic plans of the authorities for the years 2016-2020 assume GDP growth for the entire reporting period only at the rate of 12%.

Obviously, the potential to improve the external economic situation is severely limited: the probability of keeping the commodity prices low in the medium term is quite high, in addition certain risks for the global economy result from the corporate debt and slowing down of the Chinese economy. In this regard, the main source of GDP growth in Belarus lies in improving the efficiency at the micro level of the economy. In this context, the positive news is the Government's decision to develop the concept for reforming the public sector, which should be finished by the end of September. This working group is being headed by Deputy Prime Minister Vasily Matyushevsky, who is traditionally considered to be a supporter of market-based measures.

An important factor in the economic growth expectations of the authorities should be cheapening of credit resources in the economy, which is expected to be achieved through sustainable reduction of inflation. The latter in the current year should reach 12% and by 2020 should fall to 5%. But given the current level of inflation, which for the first quarter amounted to more than 5.4%, the Government forecasts are still too optimistic.

Additional inflationary pressure will create weakening the Belarusian ruble against the Russian ruble, which made up about 15% since the beginning of the year.

The situation with dynamics of the available resources is also quite controversial in the banking sector. The growth of ruble deposits in March is fixed at the insignificant level (+ 0.5% for 24 days in March, which is substantially lower than the level of capitalization). At the same time reduction of the foreign currency deposits continue to enhance the pace (in February by USD 116.6 mln in comparison with USD -25.8 mln. a month earlier). Despite this the National Bank continues to pursue strict policy aimed at reducing the rates by non-market methods. Thus since April 1, the variety of rates on new loans to the legal entities de facto narrows up to 27-33% (more expensive loans are associated with the additional costs for banks on creation of reserves). In addition the regulatory authority reduces the refinancing rate from 25% to 24%, which will also reduce the cost of loans. In fact, the National Bank assumes that in the absence of alternative savings instruments the falling of the deposit rates even lower than the equal level will not lead to a significant reduction in money supply to the economy. The situation with the bank liquidity has really improved (yet by the beginning of April in the banking system a ruble surplus was observed), which is explained by a decrease in norm of the reserves and reduction of balances on the loans.

The limiting factor for the economic growth is deterioration of the situation in such important markets of Belarus as the potash market, the milk market and the started anti-dumping investigation against the Belarusian Metallurgical Plant in terms of metal rods export to the EU. The economy of some specific enterprises could be worsened by the so-called final failure of the integration projects with Russia. Russian Prime Minister Dmitry Medvedev has already issued an ultimatum to declare the need to give up on production of the Minsk Wheel Tractor Plant due to unwillingness of the Belarusian authorities to sell it.

Social Risks

By deepening the economic reforms, the Government will inevitably be faced with the social problems increase. There is already a deterioration observed in employment, and under conditions of mass bankruptcy among the state enterprises deprived of state support, this process will only be intensified. Change of the retirement age will also create additional supply in the labor market (about 18 thou. employees, according to the Government). Herewith the reduction in cross-subsidization in the background of falling real incomes (- 5.7% in January) will provoke the risks of increasing poverty. The Government plans to neutralize these problems through a better targeting of social support and creation of an annual 50 thou. new jobs. And if the first measure looks like absolutely reasonable and promising, it is completely not clear at what kind of expense and by whom the new jobs will be created

Conclusion

Formal plans of the Government indicate willingness to activate market reforms in the economy, including when accompanied by unpopular measures. The Government is being pushed towards such situation by the continuing economic downturn and the situation of uncertainty on the foreign markets. At the same time, there remain serious doubts about the sincerity of these intentions, which again may only be a tool for negotiations with the international lenders. Taking into account the opinion of Alexander Lukashenko on deep reforms, the current policy of the Government may be subject to

adjustment in case of a serious increase in the number of insolvent companies of the public sector and emergence of social problems as a result.

Pavel Kirkovsky,
The senior economic analyst of Belarus Security Blog project.

