

**Analytical note:**  
**Monitoring of the situation in**  
**the field of economic security**  
**of Belarus**  
**(August 2016).**

### **Risks of financial instability.**

Country's external public debt continues to demonstrate the alarming dynamics, reaching USD 13,3 bn as of August 1 and having increased by 6,8% since the beginning of the year. Against a sharp drop of GDP in dollar terms as well as foreign trade turnover decline, the ratio of the external debt to these parameters has seriously deteriorated. So, on the basis of statistical data for the first half of 2016, foreign debt is almost equal with the amount of annual export and reached 25% of GDP. At the same time the formal parameter of external sovereign debt doesn't take into account the internal foreign currency debt and state guarantees on corporate foreign currency debts, which also increases the authorities' necessity in foreign exchange resources.

In fact, we can say that the government is still not able to solve the stated problem of debt servicing without its further increase. The main reason for this is the deterioration of external trade results and their significant deviation from the planned level. Thus, foreign trade deficit amounted for almost USD 150 mn for 6 months of 2016 compared with a surplus of USD 780 mn a year ago. The reason for this situation was the fall of dollar prices for the key export items of the Republic of Belarus: petroleum products (minus 34%), potash (minus 21%), metal products (about minus 20%) and dairy products (minus 14%). In general, the average export prices decreased by 19,8% while its physical volume raised by 1,2%. Since it's impossible the change the export structure in the short term, the dynamics of prices for export positions remains a key factor in the trade balance improvements. And if the price for dairy products started to show some growth (for example, it increased by 12,7% at the regular auction GlobalDairyTrade as of August 12, though the oil price still cannot exceed the level of USD 50 per barrel, and the situation on the potash market still remains uncertain. Business recovery and growth of investment demand in Russia are still short of expectations, which could stimulate export in machine-building industry. Russian economy just managed to pass from the state of recession into volatile stagnation regime.

At the same time, despite the problems in the external sector, Belarusian ruble has been rather stable for the recent months: its rate relatively to the currency basket has not changed and the strengthening to US dollar is about 1% since June 1. This situation is mostly due to the net sale of foreign currency made by the population, its total amount has already exceeded USD 1,2 bn from the beginning of the year. An essential factor of matching the balance of payments was raising funds of non-residents by the banking sector which amounted to about USD 230 mn for the last 3 months. However, such scheme of covering the balance of payments deficit can hardly be named stable. The population's capacity to finance current consumption level at the expense of foreign exchange reserves is clearly limited, and in course of time the offer on the currency market will inevitably start to shrink.

In such situation the additional external funding and increase of golden and foreign exchange reserves level (hereinafter referred to as FX reserves) remain an extremely important task for the authorities. Thus, Fitch Agency estimates the need of the Republic of Belarus in external financing at the level of 182% of FX reserves, which is the highest level for the rated emerging economies. Obviously, for this reason the authorities are showing a greater willingness to find compromises with the creditors and fulfill their requirements, including those avoided before. Thus, according to the decision to

introduce a mechanism of providing housing subsidies for low-income citizens since October 1, the government is preparing for another essential increase of utility tariffs for the population. As part of the currency market liberalization, government reduced the norm of compulsory sale of currency revenues from 30% to 20% since September 1. The matrix of measures agreed with the EFSD is also carefully executed that gives hope to receive the next tranche of credit in the amount of USD 300 mn in September-October.

Concerns regarding the anticipated government's mitigation of monetary and fiscal policy are not still confirmed. Despite the serious reduction of interest rates and their approximation, according to the National Bank's opinion, to the equilibrium level, a sharp rise in demand for loans has not been observed. Thus, while the rate on newly issued corporate loans was reducing from 34,2% at the beginning of the year to 24,7% as of July 1, the growth of debt for corporate ruble loans amounted to a symbolic 0,7%. The dynamics of deposits didn't change significantly as well: a slight outflow of foreign currency deposits was accompanied by a small increase of ruble deposits. The amount of money supply fluctuates rather slightly (it decreased by 0,2% from the beginning of the year), and certain growth of cash in late June - early July was temporary and was caused by the formation of cash reserves made by the population at the time of denomination. Budget implementation is carried out with a surplus of 3,2% of GDP, in this regard the authorities cut the planned expenditures, having reduced the gap in public costs financing from BYN 670 mn to BYN 370 mn. The authorities' plans for the next year are rather conservative: GDP growth by 1,5% is planned in case of the oil price of USD 35 per barrel, Russian ruble exchange rate of 75 and the dynamics of Russia's GDP of 99%. Meanwhile the government continues to focus mainly on reducing the inflation level which reached 0,4% in July, and in annual terms – 12,2%. Actually, among the whole list of targeted indicators for the first half of the year, which was determined by Alexandr Lukashenko as a control time frame for the evaluation of government's effectiveness, the inflation level was the only one executed parameter. However there was no public criticism of Government which actually means the approval of the current Council of Ministers policy.

### **Risks of economic recession.**

Forced and tight monetary and fiscal policy is an additional factor of the continued economic recession. By the results of July, the economic recession worsened after a short break – GDP declined from 2,5% in the first half year to 2,7% for the first seven months of 2016. According to the opinion of Prime Minister Andrey Kobayakov, GDP declined by 0,2% due to the reduction of Russian oil supplies caused by another gas conflict between Russia and Belarus. According to some information, since the negotiations on gas price are still close to the end, this factor may be offset in the coming months. An additional incentive for the economic growth is a decrease of gas prices which can be achieved by the results of negotiations. Thus, according to the media, Russian authorities are ready to nominate the gas price for Belarus in Russian rubles and tie it to the internal Russian prices, which will simultaneously reduce its price from USD 132 to USD 92 for thou. cu. m. Total annual effect on the Belarusian economy in this case will be about USD 800 mn, which is certainly good news. But some other obvious drivers accelerating the dynamics of economy, noted by government, are not observed. A serious drop in household income (minus 7% for the first half year) restrains the development of the internal market, while cutting off budget expenditures has a negative impact on the investment activity. GDP dynamics will be worsen also by the weak grain productivity

(33,7 dt/ha against 39,5 dt/ha last year) caused, under normal weather conditions, by the fertilizer treatment at the level of only 50% of demand due to the lack of government funding.

The weakness of the real sector in its turn creates a significant problem for the banking system. The growth of bad debts continues for the 9th month and it reached a significant level of 14,3% in August. According to popular belief, its real level is even higher, because much of the debts of insolvent companies are provided with state guarantees and are classified as trusted. The authorities promise to take measures to restrain the level of bad debts which obviously implies their refinancing at the expense of budget funds. This in turn will further reduce the level of government expenditures for other purposes and will have a curb influence on economic activity.

### **Risks to economic independence.**

The development of situation regarding the external public debt allows to note a serious increase of financial dependence of Belarus from Russia. It happened so, that Russia and its controllable financial institutions act as the only sources of refinancing of foreign debt – for 7 months of 2016 their share in new funding accounted for over 82%. At the same time most part of payments for the Belarusian public debt fall on Russia and its institutions – almost 65% of payments for the same period. On the one hand, this situation allows the Belarusian authorities to count on financial stability even with a significant deterioration of the formal sustainable development indicators by using political arguments in the negotiations. On the other hand, the Russian authorities, along with the possibility to use trade restrictions, get a serious instrument of pressure on the Belarusian government. In particular, it will be more difficult to block the access of Russian capital to the Belarusian state property objects, especially with the decreasing problems in the Russian economy. Thereby only an increasing trend of Belarusian dependence on the dominant creditor may be observed.

### **Summary.**

The Belarusian economy continues to show a fragile stability. The most serious risk to financial stability is the deterioration of the external sector. Possible weakening of the national currency, provoked by the external factors, can seriously aggravate the existing problems of Belarusian economy and offset current achievements of the authorities: to change the dynamics of inflation, to provoke an outflow of deposits, to accelerate the growth of bad debts in the banking sector, to exacerbate the problem of external public debt. At the same time a successful resolution of oil and gas conflict with Russia and reduction of gas prices can be a significant factor in improving the foreign trade balance as well as the dynamics of the economy.

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