

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

Risks of financial instability

IMF can be considered as the main newsmaker of the month which was marked by a fundamental report on the economic situation in Belarus and the visit of its specialists to Minsk with an unexpected mission. The report was prepared by the Fund's staff by the results of June visit to Belarus and traditionally included both an assessment of the authorities measures, current state of economy and its prospects, and a set of recommended economic activities. IMF experts consider the key risk to the economy in the medium term is the risk of acceptability of public debt level. The Fund strongly recommends the authorities to set the target parameter for the level of public debt not exceeding 70% of GDP and its annual service costs not more than 15% of GDP. Though according to the IMF, the current amount of government debt in the broad definition (i.e. including state guarantees and debts of local authorities) has already reached 54% of GDP, and over 86% of it falls on foreign currency debt. In the baseline scenario of economic development (i.e. in case of reject of the authorities to extend structural reforms) these limits may be reached as early as by 2021 according to the IMF estimation. Such dynamics of public debt is explained by the persistent current account deficit, which could reach 5% of GDP by the end of 2016 comparing to the deficit of 3.8% of GDP a year before. One more reason compounding the problem of debt is the continuing economic recession expected by the IMF at the level of 0.5% in 2017. Financial problems of strategic state enterprises increase the probability of obligations on state guarantees and create a necessity for recapitalization of state banks. The IMF estimates that this will lead to additional pressure on the budget in the amount of 15.5% of GDP during the period until 2021.

IMF calculations show that in order to have the acceptable balance of payments parameters it is necessary to weaken the real effective exchange rate of ruble by almost 10%. At the same time, IMF experts do not recommend the authorities to carry out another devaluation, because it will have extremely negative impact on the banking sector and financial stability of the economy as a whole; IMF offers to achieve the same result through the implementation of structural reforms – reform of the public sector and the restructuring problem enterprises as well as avoiding cross-subsidization practices. These measures should increase the efficiency of resource use in the economy, reduce the real budget deficit and improve the results of foreign trade. To stimulate economic growth in case of reforms in the short term, the Fund regards the possibility of weakening the fiscal policy and temporary deficit accrual, directed also to the compensation payments to the population. However, further fiscal consolidation is required annually at the level of 0.5% of GDP, which can be reached through the wages restraint in the public sector and raising the retirement age up to 65 years.

It can be stated that there is a visible consensus between the authorities and the IMF representatives regarding the monetary policy, however the question of structural reforms and fiscal consolidation encounters evasive response of the government. Apparently, the latest negotiations in Minsk were held in a similar evasive tone. The government generally agrees with the recommendations of the IMF, but occupies a dual position on key issues (in particular, reforming the public sector, development of the restructuring mechanism and the liquidation of inefficient enterprises, increase for HCS expenses up to 100% by 2018). Thus, the Government agrees to reject cross subsidizing of housing and communal services by 2018, however, it plans to do it not through the increase of tariffs for the population, but rather through the decline in utilities costs.

Based on the current level of compensation for these services by the population, which is estimated by the authorities at about 58%, this task looks practically unachievable. The authorities haven't decided regarding the public sector reform, its strategy is still in the development stage. However, the idea of using a widespread practice of bankruptcy of insolvent state enterprises is considered as not appropriate with the social orientation of the Belarusian system. Some Government members deny the need for significant changes, considering the current economic problems as a result of a temporary deterioration in the external environment. Aleksander Lukashenko sharply criticized the necessity for cutting social expenses and refused to sign a letter of intent in its current form requesting to review it. However, despite this, some Government members are still confident in the positive outcome of negotiations with the IMF on the harmonization of the new program.

Both positive and negative trends still persist in the financial sector. Thus, the level of bad debts in the banking system shows growth almost reaching 14.8%. Despite these figures, the authorities continue to assure of that the situation is under control. A weighty argument for this statement is the result of an independent audit of the country's nine largest banks, accumulating 92% of bank assets, which was held by the recommendations of the IMF. In September, the National Bank published its results which were generally quite positive. So, taking into account the assessment of assets quality, capital adequacy level in the banking system as a whole exceeds the norm. At the same time potential problems were detected only in 3 banks (Russian Alfa-Bank and state Belagroprombank and Belinvestbank); and the largest country's bank Belarusbank showed capital adequacy ratio at the level of 17.5% with the prescribed norm of 10.625%. Apparently, the identified problems will be promptly blocked due to the mobilization of resources from the parent companies and debt restructuring of borrowers (for example, by transferring bad debts to the Asset Management Agency created in August specifically to operate with the agriculture debts).

A favorable situation is noticed for the reducing of rates on the ruble market. For the first time during the last 7 years a deflation of 0.1% was recorded in August, even if the reasons were mainly seasonal. Ruble deposits showed quite good growth (+ 1.8%), and the reduction of foreign currency deposits slowed down (-0.18%). Net sales of foreign currency made by the population achieved a record level during the year and amounted to 282,1 mn USD in August. Foreign trade situation allowed to maintain the stability of the ruble to the currency basket in September (its weakening was less than 0.5%) and to strengthen its exchange rate against dollar by 1.7%, which should stimulate the growth of public confidence in the national currency. As a result, rates on newly issued ruble loans to legal entities fell by 1,5-3,4 percentage points in August to the level of 18,7%-21,8%.

Risks of economic recession

Failure to supply Russian oil led to a further drop in GDP of 0.3%, which contributed to the overall deterioration of its dynamics to minus 3% in January-August 2016 compared with minus 2.7% a month earlier. The second factor of deepening economic recession were the results of agriculture, which demonstrated a decrease of 2.2% due to weather conditions and lack of funding. At the same time it is worth noting some improvement in the industry: the recession in the industry slowed down from 2% to 1.8%, while stocks of finished products have reached the lowest level since January 2013

level (64.7% of the average monthly production). A small increase in the average salary is fixed in nominal ruble and dollar terms (+ 0.6% and + 2.4% respectively). Certain improvements have been achieved on foreign markets: the price of oil rose due to the agreement to freeze production by OPEC countries and was fixed at a level slightly above USD50 per barrel at the beginning of October, the IMF has improved the forecast for the economic growth in Russia (-0.8% in 2016 and + 1.1% in 2017). In fact, current external economic conditions are significantly more favorable than those planned by the Government as a base for 2017 (the price of oil is USD 45 per barrel, dollar - not more than RUB 70), on the basis of which the authorities expect the growth of GDP at 1.7%. Given the historical tendency of Government to overestimate the forecasts for GDP, in case of maintaining the current external situation we can expect the economic growth close to zero with a small deviation in both sides in 2017. However, in any case, the probability of extremely adverse scenario has significantly reduced.

Risks to economic independence

Short-term risks are still connected with the potential sharp deterioration of external trade terms, relevant in light of the current oil and gas conflict with Russia. Despite the August information regarding the finalization of the negotiations, the authorities didn't reach the agreement on gas prices. Probably, we can see the creeping escalation of the conflict: after sharp public statements of A. Lukashenko the Belarusian government has unilaterally increased the oil transportation costs via the Belarusian pipelines by 50%, while Russian officials pointed out the complaints to the next re-export of prohibited products. According to some reports, Belarusian side does not agree to a compromise price of USD 100 proposed by Russia, requiring its reduction till USD 73. The logic of Belarusian authorities can be certainly understood – the additional discount will improve the balance of payments and, consequently, reduce the need for sensitive reforms. However, the current situation is not in favor of Belarus: Russia has already reduced the supply of oil in the 3rd quarter by 40% and plans to reduce it almost by 50% in 4Q (to 3 mn tons instead of 5.7 mn tons according to the plan). The next tranche of loan of the Eurasian fund for stabilization and development can become doubtful, while the authorities hoped to receive it in September-October.

Summary

Key uncertainties in the short term period are the finalization terms of oil and gas dispute with Russia and reaching the agreement on a new program with the IMF. Favorable solution of both issues will improve the conditions for the preservation of financial stability and economic growth in the country. However, the possibility of launching deep structural reforms, which are a key condition for receiving funding from the IMF, also remains unclear because of the political position of the government.

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

