

Analytical report:

**Monitoring of the situation in
the field of economic security
of Belarus (August 2018)**

Minsk

The risks of financial volatility

In August, the situation in the markets of developing countries continued to deteriorate rapidly. Turkey (the lira rate has fallen by almost 40% since the beginning of the year, inflation accelerated to 15.9%, the probability of collapse of the banking system increased dramatically) and Argentina (the authorities had to raise the refinancing rate to a record 60%) are in the forefront of the deterioration. Also, Brazil, Iran, South Africa, Russia, Ukraine, Kazakhstan and others faced a significant problem of capital outflow and devaluation of the national currency. Due to the weak development of the stock market in Belarus, these trends affect the country mainly through the trade channel. Strengthening of BYN to RUB, observed throughout the year, led to a deterioration in the results of trade with Russia.

In June-July there was a reduction of commodity exports to Russia (in terms of month to month for USD 36 million and USD 82 million, respectively), and in the end of this period the exports was USD 149 million lower than in the same months of the previous year. As a result, in late August - early September, the process of forced weakening of BYN to all currencies of the National Bank's started. Although against the background of other developing countries, the indicators of the national currency fall and look quite modest (for example, since early August USD has grown by about 5% and the currency basket - by 1.5%), devaluation poses a serious threat to the Belarusian economy. Even with current parameters, devaluation will accelerate inflation and create prerequisites for growth rates in the economy. Moreover, for the first time since 2014, the management of the Central Bank of Russia stated that there are factors in favour of raising the key rate.

Under the unfavourable scenario (for example, when RUB falls down above the RUB 80 / 1 USD level due to tightening of US sanctions), a large devaluation of BYN could provoke another period of macroeconomic instability. At the same time, the mechanism of imbalance will most likely differ from the one that took place in 2014. Due to the increase in the share of irrevocable deposits, the authorities have reduced the risks of the depositors' "run" on banks and the explosive growth of demand for cash currency by the population. The main burden will be taken by banks that have a significant amount of potentially bad foreign currency loans, and a budget that is forced to finance public debt servicing. Thus, according to the National Bank, when BYN depreciates against USD by 1%, the loss of enterprises from the revaluation of foreign currency debt will be BYN 230 million, the budget loss from the revaluation of the external debt - BYN 330 million. At the same time, Belarusian authorities can not protect themselves from such a scenario because of the purely external nature of devaluation risks, and because of the limited size of foreign exchange reserves.

The risks to economic growth

The most media event of the month was quite unexpected resignation of the government of Andrei Kabyakou, which occurred despite the fact that the current year so far is the most economically successful over the past 8 years. Thus, GDP growth is 4.4%, inflation remains at a historical low (in July, for the second time in a year and for the third time in a sovereign history deflation was observed), and the population's incomes show a significant increase (+ 7.6% for the first half of the year). The formal reason for the resignation of the Government was the failure of the program to restore the economy of the Orsha district, which was launched in the summer of 2017. This program was to

become a model for the modernization of a particular region, and its experience was supposed to be extended to other depressed industrial centres. However, in the situation of budgetary constraints, the project did not achieve significant success, moreover, the Government and local authorities failed to fulfil a number of specific assignments of Aliaksandr Lukashenka (for example, repairing the roof of an instrument factory).

At the same time, the replacement of the Government has so far been declared as a purely technical replacement of the performers, who are called upon to solve the old tasks (source) more effectively. Despite the obvious fundamental problems of the system of state administration of the economy, the new Government is not endowed (at least publicly) with a mandate to undertake any structural transformation. At the same time, the economic block of the new Council of Ministers is certainly more liberal (in 2011 Lukashenka criticized the current Premier Siarhei Rumas for excessively market approaches), which can not but affect local solutions and management style in general. Thus, the new Vice Prime Minister Aliaksandr Turchyn has already spoken out against the arrest of businessmen in the investigation of economic crimes, and Premier Siarhei Rumas criticized the local authorities for pressure on the private sector. At the same time, conducting no changes in the law enforcement agencies (primarily the State security committee and State control committee) that had previously acquired a sufficiently serious “weight”, creates the potential for possible conflicts with the new members of the Government.

The change of the Government took place against the background of a significant deterioration in external conditions, which reduce the prospects for economic growth in the country. The government has already been forced to revise forecasts for 2019 downward. According to the target scenario, the GDP growth was reduced to 104% (previously 104.1%), on the base scenario - to 102.1% (previously 102.8%). On the part of external demand, the slowdown in Russia’s economic growth is the main constraint. Oil prices’ stabilizing below expectations, growing instability in developing markets and the consequences of sanctions forced the Russian authorities to lower the forecast for economic growth in 2019 to 1.3%. In fact, the only external positive factor for the Belarusian economy is the rise in potash prices, recorded by a new contract with India. In such conditions, the new Government has to make the main bet on domestic demand. Thus, its share in the expected GDP growth is estimated by the authorities at 75%, while an important role is assigned to the growth of the service sector.

The most important stimulus for the domestic market should be the growth of incomes of the population. As part of this policy, the authorities have already increased the incomes of public sector employees since September, while payments to their certain categories are increasing more significantly. Thanks to these measures, the average salary in the budgetary sector, according to the calculations of the Government, should reach the level of BYN 858 by the end of the year. However, the situation on the part of the domestic market does not look absolutely optimistic either. The implementation of tax manoeuvre in Russia as early as 2019 will lead to a shortfall in the budget of Belarus in the amount of BYN 600 million. As a result, budget revenues in 2019 are forecasted to fall even in nominal terms, which will negatively affect domestic demand. The risk of sharp cooling of the credit market, which can occur as a result of the forced increase in rates, is also essential. Acceleration of inflation in case of further BYN weakening will

negatively affect the real incomes of the population. Deteriorating economic expectations will in turn restrain private sector investment.

The risks to economic independence

The disagreement with Russia in the oil sector will also have negative impact on the economy. The Russian authorities have announced the restriction of the export of petroleum products to Belarus. They believe the Russian petroleum products are used for re-export under the guise of other products, which leads to losses for the Russian budget. In fact, we are talking about Belarus repeating schemes with exports of the so-called diluents and solvents that took place in 2011-2012. Judging by the statistical data, this kind of export operations (an average of about USD 80-100 million per month) gave the Belarusian budget certain tax revenues. According to some media, the Russian authorities demand compensation for their budget losses and intend to stop issuing loans to Belarus. Officially, this information was not confirmed and one can still talk only about the suspension of transfers to the Belarusian budget from the mechanism of double taxation.

The issue of obtaining the next tranches of the Eurasian Stabilization and Development Fund's loan is still open. In such a situation, the proposals of the Belarusian authorities on the development of an additional mechanism for inter-budgetary compensation in the case of introducing a negative excise tax for oil producers appear untimely. According to the Belarusian authorities such compensation should allow to form a single fuel market in the event that the Russian government subsidizes its producers. At the same time, it is obvious that the Russian authorities are trying to reduce the subsidy of the Belarusian economy against the background of a reduction in their own budgetary expenditures, including when implementing pension reform.

Conclusions

The growing external economic uncertainty actualized the problem of the vulnerability of the Belarusian economy to external shocks. The devaluation of RUR, caused by the outflow of capital from emerging markets and the possible strengthening of US sanctions, creates a significant tension in the Belarusian economy. In the case of a significant tightening of anti-Russian sanctions, the banking and budget systems of the country will be in a vulnerable position. The current situation is further exacerbated by attempts by the Russian authorities to audit interstate financial flows.

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