

**Analytical report:**

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

## **The risks to economic independence**

The main intrigue of December was the Belarusian-Russian negotiations on Belarus's receiving compensation for losses from the tax manoeuvre in the oil sector of Russia. As a result, it can be stated that they went in an extremely unfavourable manner for Minsk. After Belarusian authorities' attempts to toughen their negotiating rhetoric, raising the issue of non-observance of equal economic conditions in the EAEU, Russia responded by an ultimatum with the demand for deeper integration. Russian authorities consider change in the mechanism of taxation of the oil sector the internal affair of Russia, not subject to coordination with partners in the EAEU. Formally, the creation of a single energy market was postponed for 2025 by the formation agreement of the EAEU and the pricing mechanism for the transition period was not provided for. At the same time, obtaining additional preferences by the price of oil and gas by Belarus is a matter of bilateral relations. According to the Prime Minister Dmitry Medvedev, the Russian authorities are ready to ensure equal conditions for the Belarusian economy with neighbouring Russian regions only if Belarus fulfils the 1999 treaty on the creation of the so-called "Union State". In particular, the articles like the formation of a single economic, judicial, customs, tax and monetary policy, including the transition to a common currency and a single issuing centre. In fact, it is proposed to give up a substantial part of economic sovereignty, while retaining only the formal attributes of statehood.

If the Belarusian authorities do not succeed in changing the position of the Russian government or they fail to once again use the tactics of delaying the implementation of the agreed decisions, the Belarusian economy will face substantial losses in the coming years. The direct costs of tax manoeuvre for the Belarusian budget are due to the forced reduction of fuel excise taxes (already in 2019 their size is reduced by 25%) and the gradual zeroing of the export duty on petroleum products. So, in 2019 alone, the budget will lose about BYN 630 million, then the amount of losses will increase annually. The economic conditions of the oil refineries will significantly worsen: if they now buy raw materials at a price of about 75% of the world market, by 2024 this competitive advantage will be completely lost. As a result, the profitability of oil refining will be under threat, the risks of losing not only the external, but even the internal fuel market due to the absence of borders with Russia will be significant. As a result of the action of only these factors, Belarus's losses over 4 years could reach USD 11-12 billion. In addition, the general deterioration of Russian-Belarusian relations inevitably creates other threats related to the servicing of foreign debt and the trade balance deficit. Thus, a series of negotiations on Belarus's receiving Russian credit support are in the active stage. The question of the last tranche of the Eurasian Fund for Stabilization and Development remains open, the Belarusian authorities expect to receive a new intergovernmental loan in the amount of USD 630 million to USD 1 billion, as well as credit conditions for the construction of the nuclear power plant. There is no agreement on the size of gas prices after the current agreement in force until 2020, the problem of creating barriers for Belarusian goods on the Russian market remains sensitive.

## **The risks to economic growth**

Despite the obvious difficulties in compensating for losses from the tax manoeuvre, as well as the gradual increase in risks in the global economy, the Belarusian authorities approved quite ambitious plans for 2019. Thus, GDP growth should reach 4%, which will

be the best result since 2011. It is planned to ensure such economic growth due to the growth of investments (their increase is expected at the level of 9.5%) and domestic consumption (the growth of incomes of the population should be 3.4%).

The government's plan looks too optimistic against the background of the recent economic results. The dynamics of economic indicators shows the end of the economic recovery cycle. Thus, GDP growth in November decreased to 3.2% after 3.5% a month earlier, while a slowdown was observed in most segments of the economy (in industry from 6.4% to 6.1%, in agriculture from minus 2.5 % to minus 3.5%, in retail from 8.9% to 8.8%). The quarterly statistics also shows the weakening of the economic growth. Thus, according to some calculations, already in the third quarter, the growth of the national economy in relation to the previous quarter (with a cleansing of seasonality) was only 0.1% in annual terms. Even without taking into account the losses from the tax manoeuvre, the external situation develops moderately negative: the price of oil remains below the budgeted level of USD 60 per barrel, the economies of most countries, especially developing ones, are slowing down, tightening monetary policy in the US and the EU creates risks of falling stock markets. In such circumstances, it is more expedient to expect a slowdown in economic growth to the level of 0.5-1.5%, and in early 2019 some decline may be observed.

In the current situation, the optimistic plans of the authorities can only be explained by political necessity: 2019 may be the year of the next presidential election, and it is important for the authorities to achieve the economic growth embodied in the development program for 2016-2020. In case of failure, according to the results of the second five-year period in a row, it will be quite possible to talk about a lost decade for the Belarusian economy. Under such conditions, risks of a return to practices of excessive stimulation of GDP growth will seriously increase, which may be accompanied, among other things, by easing of monetary policy.

Under the conditions of taboo on structural changes, the Government is trying to use the tactics of creating new points of economic growth. The brightest projects of such a policy are the High-Tech Park and the Chinese-Belarusian Technopark "The Great Stone". And if the first one already gives a significant result (so, in 2018, the number of park residents reached 454, and their exports should exceed USD 1.4 billion (+ 40% compared to the previous year)), then the period of the formation of the second one obviously lasts too long. Last year, the number of its residents also increased (from 23 to 44 organizations), but it's too early to say about the significant economic effect: for example, investments in the park in 2018 amounted to only USD 180 million, and data on residents' exports is not available. At the same time, the economic authorities are working on non-trivial ways to revitalize the park: in particular, the Belarusian Ambassador to China Kiryl Rudy publicly expressed the idea of creating a so-called "industrial offshore" on the basis of the park. According to his idea, the park, while remaining a resident of Belarus, should receive a special status allowing it to independently conclude free trade agreements with other states, including China, EU, USA, etc.

The authorities are trying to solve the problem of the Orshansky district in a similar way. By order of President Lukashenka to government in 2017, the district was supposed to become a model region. So, in late December, a presidential decree, approving the development program for the Orsha district until 2023, was signed. According to the

decree, residents of the district will receive many preferences designed to increase its investment attractiveness. In addition to traditional tax breaks (a reduction of social security fund contributions from 34% to 30%, exemption from VAT on equipment imports, a reduction to 1% tax under the simplified system, etc.), the program also provides for measures such as limiting criminal penalties for economic crimes, the possibility of using the building codes of China and the EU, exemption from environmental costs during construction, etc.

The general economic efficiency of such measures is still in doubt, at the same time it is obvious that they will create the risks of abuse, distort regional incentives and complicate state administration.

### **The risks of financial volatility**

When planning the budget for 2019, the Government once again used the scenario of economic development, which worse than one approved by the development program. Thus, in budget calculations, economic growth was used at the level of 2.1% of GDP, inflation was 5.3%, losses due to tax manoeuvre were taken into account. As a result, the nominal growth of budget revenues is planned only at the minimum level (0.8%), and the fiscal risks in 2019 are estimated by the authorities as below the average.

At the same time, the gradual increase of devaluation and inflation risks in the economy becomes obvious. This forced the National Bank to refrain from reducing the refinancing rate at the second quarterly meeting. Moreover, in the explanation to its decision, the regulator rather focuses on the arguments explaining why the rate was not raised. Among these arguments National Bank mentions the high risk of imports of devaluation-inflationary processes from Russia, where national currency has fallen to more than 4% against USD over the past month. BYN, in turn, strengthened against the Russian currency by 9% in 2018. Given the dependence of Belarusian exporters on the Russian market, such a strengthening cannot be sustained, and if the Russian currency is kept at the current level, and status quo will be back in the coming months. This situation may further stimulate inflation, a surge in which the authorities already expect in early 2019. Taking into account the growing risks for the deposit market, the regulator began to work out the lifting of restrictions on the maximum level of interest rates on household deposits. Such a decision will give banks the ability to quickly respond to fluctuations in the money supply on the part of investors, but at the same time may lead to an increase in the cost of borrowing in the economy.

The past year could not be called successful for foreign debt and international reserves. Despite the plans of the Government, the size of foreign debt increased slightly (+ 0.4%) and as of December 1, 2018 reached USD 16.8 billion, while the size of gold and foreign exchange reserves declined (from USD 7.32 billion to USD 7.16 billion). At the same time, a positive point is that the relative level of public debt to GDP reduced in 2018 (if at the beginning of the year it was more than 39% of GDP, at the beginning of October it dropped to 36% of GDP). True, in the event of a further BYN fall, this trend can be reversed. A negative factor here is the growth of the potential cost of attracting resources in foreign markets (for example, the current yield on 12-year-old Belarusian bonds reached 7.3%), which is associated with tightening the monetary policy of the Federal Reserve System and capital outflow from emerging markets. At the same time, the authorities continue to assert that there is no urgent need to seek external financing, and all the requirements for it for 2019 are fulfilled.

## **Conclusions**

For the first time in a long time, the Russian authorities have publicly put forward the demand for deeper integration within the framework of the Union State, suggesting the actual loss of economic sovereignty by Belarus. Failure or delay of the process by the Belarusian authorities can lead to sensitive losses for the economy, seriously limiting the potential for economic growth. The risks of maintaining financial stability are aggravated by the expected start of the election cycle and the political need for the economy to form positive short-term results.

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