

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

Risks of financial volatility

The dynamics of formal indicators allows to speak about the improvement of the state of financial sector of the country. A significant net supply (about USD 192mn in September) remains on the currency market provided by the country's population. This in turn has a positive effect on the exchange rate of ruble which has strengthened during the past month against a currency basket and dollar by more than 1%. National Bank took advantage of this favorable situation on the foreign exchange market and increased gold and foreign currency reserves (hereinafter referred to as the gold reserves) by USD 62 mn in the past month. A sign of growing confidence into the ruble may be considered the increase of ruble deposits amounting to 3% in September. At the same time the National Bank fixed the growth of the share of irrevocable deposits from 32.2% in January to 54.1% in September. This significantly reduces the probability of another increase of number of bank depositors which was repeatedly observed over the last 5 years as a market response to the negative information. It is important that this result was achieved against a significant drop of rates on the deposit market: for example, the average rate for new irrevocable deposits fell to 18.1% in September compared to 27.9% at the beginning of the year. Similar dynamics is observed on the credit market: new loans to legal entities fell from 34.2% to 22.2% over the same period. At the same time the weakening of monetary policy can't be noted: the growth of ruble money supply from the beginning of the year amounted to slightly more than 8%, while the annual inflation rate is going to be the lowest since 2010: it reached 8.3% from the beginning of the year. For the first time over 12 months the situation with bad debts in the banking sector has improved, reducing from 14.8% to 14.3%. A negative fact is the growth of external debt by 7.9% since the beginning of the year up to USD 13.4 bn, which is caused by the bad results of foreign trade compared with planned indicators.

However, the further success of government policy regarding the financial stability will greatly depend on reaching an agreement with the IMF about the beginning of the new program. In addition to the amount of IMF loan which can reach 3-3,5 bn USD, the cooperation with the IMF will help the authorities to attract the World Bank resources, the Eurasian Development Bank and the International Finance Corporation resources in the amount of up to USD 1 bn.

The authorities also count on the fall of the price of new borrowings on the Eurobond market, which in case of the start of the program, is estimated as 1.5-2 percentage points. Therefore, despite the public criticism of IMF requirements on the part of Aleksandr Lukashenko, the government still continued negotiations with the management of the Fund. In the coming months, two technical IMF missions are planned to visit Minsk with the objectives to discuss public sector reform and the reduction of cross-subsidization. As a result of close cooperation Government expects to have a decision on the IMF program in December 2016 - January 2017. This, however, will only be possible in case of making political decisions on the growth of tariffs for the population and the reduction of support in the public sector.

Risks of economic default

Fall of interest rates and reduction of the cost of credit resources has not yet led to a positive effect in the real sector. GDP drop remains at substantial 2.9% and incomes in real terms decreased by 7.1%. The authorities have rather optimistic plans to achieve the economic growth of 1.7% next year. Forecasts of financial institutions contain

considerably more modest assessment: from -0.5% by the IMF to + 0.9% by the Eurasian Economic Commission. To achieve the stated objectives, the government relies on 3 growth points: public investments in innovative projects, operation of the industrial park "Great Stone" and the growth of the share of small and medium-sized enterprises in the economy (hereinafter SMEs). However, the previous experience of major public investments (especially failed modernization projects of wood and cement industry) makes doubt that applying of this tool will provide a significant positive result. The draft project of Belarusian-Chinese park "Great Stone" looks overvalued which cannot yet boast a large number of residents and even requires additional incentive benefits according to the authorities view. In general the volume of investments planned for this project in 2017 (about USD 60-70 mn) is too small to generate significant results for the whole economy. On the other hand, the achievement of the authorities is the improvement of conditions for business development, which is recorded in a new ranking of Doing business. In this ranking Belarus has demonstrated an impressive growth, rising from 50th to 37th place. The Government intends to continue working in this direction and plans a number of changes in the legislative regulation in 2017 aimed at improving the business climate and the credit program for SME with cheaper rates of 10% per annum. At the same time, the effect of these measures is likely to be essentially limited. Constraints for the development of SME will be weak domestic and external demand: government plans to cut expenditures of the national budget in 2017 by more than 1% in nominal terms and by 10% in real terms, and the growth of economic activity in Russia is expected rather modest. Another factor limiting the development of SME is a significant inefficient public sector, which acts as a competitor to the private sector for resources and customers, but is funded by administrative order on favorable terms.

The authorities state themselves that the key question in economic policy should be the increase of the efficiency of the public sector. To evaluate the risks and the status of the largest companies, government plans to make their independent audit. According to the results, the companies will be divided into 3 groups, each will have their own economic policy. Thus, the enterprises of the first group having a satisfactory financial performance will focus on improving the system of corporate management. The enterprises of second group, whose current activity is effective and the financial problems are caused by significant debt, will concentrate on restructuring debts in various ways. The ineffective enterprises, falling into the third group, will be subjected to rehabilitation and eventual bankruptcy.

At the same time, the Government has not mentioned concrete steps for changing the system of economic incentives to improve the autonomy of enterprises, the transition from the rigid vertical management to a more flexible, without which the solution to the problem of efficiency of the enterprises does not seem possible.

The political willingness of the authorities to go to the elimination of chronically inefficient enterprises seems doubtful. In public discourse, the authorities say about the only isolated cases of future liquidation and the predominant use of rehabilitation mechanism – that is, solving company's problems by its creditors. The proposal of the Prime Minister Andrey Kobayakov – to appoint the existing managers as crisis managers in the process of rehabilitation – sounds surprisingly. A striking example of the desire of the authorities to preserve the Soviet brands without considering the economic feasibility is a story of "Motovelo" enterprise, when Aleksandr Lukashenko insisted on its rehabilitation by public funds.

Risks to economic independence

Termination of the oil and gas conflict between Russia and Belarus is delayed again. In the first half of October the officials reported about reaching a compromise: the gas price for Belarus is reduced to the level of RUB 6 thou per thousand cubic meters, which is more than USD 73 previously required by Belarus, but Russia undertakes to pay additional interbudgetary compensation to the budget of Belarus. The amounts of such compensation, which could reach USD 400 mn in 2016 and USD 800 mn in 2017, will be used by the authorities to reduce tariffs for domestic consumers. At the same time Belarus has to sign the agreement on united energy market and to pay the accumulated debt for gas which amounted to USD 280 mn at the end of October. Only after that Russia will restore oil supplies to Belarus whose decrease affected negatively the dynamics of GDP. However, this agreement hasn't been legally fixed, but was supposed to be signed by the Prime Minister of Russia Dmitry Medvedev in Minsk and was linked with some other agreements (formerly the Russian authorities tried to link the discount on gas with the promotion in the field of so-called integration projects). At the same time Belarus, according to the Belarusian Prime Minister A. Kobyakov, agreed to pay USD 132 for gas. Other details such as current conditions of gas purchase, payment terms of the Belarusian debt, increase of oil supply were not publicly announced yet. The third loan tranche of EFSD hasn't been transferred, although the officials of the Ministry of Finance of Belarus optimistically expected to receive it by the end of October.

Summary

Government financial stabilization policy continues to give positive results: inflation decrease, growing confidence in the ruble, reducing credit risk premium. However, positive shifts are not observable in the real economy sector. The announced government proposals on the reform of public sector look as attempt to reduce the debt burden on enterprises without addressing to the internal causes of their inefficiency. The key issue of the next few months is reaching an agreement with the IMF about the start of credit program, which will also act as the guarantor of sufficient external financing and the willingness of the authorities to serious structural reforms.

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

