

**Analytical report:**

**Monitoring of the situation in  
the field of economic security  
of Belarus (June 2017)**

### **The risks to economic security**

It seems that Belarusian-Russian relations are stabilizing after a certain confrontation related to Russia's failure to implement integration agreements on the energy market. Belarus received the next tranche of the loan from ESDF surprisingly easily and it should receive a new intergovernmental loan in the near future. Russian authorities also express their readiness to accelerate the creation of a single market for energy products. In addition, Russia actually removes from the agenda the issue of "integration projects" in the old form, which in fact meant granting Russian capital access to the major Belarusian enterprises. It can be assumed that such a change in the policy of Russian authorities is connected with the start of a new electoral cycle and their unwillingness to create a negative information background around the EEU during the presidential campaign.

The number of planned Chinese projects in the Belarusian economy continues to increase. Thus, an agreement on investing USD 1 billion by the Chinese company DRex Food Group in the agricultural sector in the east of Belarus was signed. Some new projects in the Belarusian-Chinese industrial park "Great Stone" were announced as well. At the same time, as expected, the number of operating enterprises wishing to enter the park or to obtain similar conditions for activity is growing. If a positive decision is taken in this direction, this will distort the incentive system for state enterprises and reduce the revenues of the state budget.

### **The risks of economic recession**

The country's GDP level for the 5 months was significantly better than planned before and grew by 0.9% instead of the planned 0.2%. This was mainly achieved due to the increase in the industry sector, where the growth since the beginning of the year was 6%. The main factor of this achievement was the restoration of demand in foreign markets, primarily in Russia. The export of goods for 5 months of 2017 grew by 22.9%, and exports to Russia - by 29.8%. This is connected both with the growth of investment demand in the Russian market and with the improvement of the exchange rate for the Belarusian producers. The real rate of BYN to RUR in January-May of 2017 decreased by almost 11% in comparison with the same period of 2016.

At the same time, even the Government itself views current economic growth as a recovery and does not expect its significant acceleration in the future. So, according to the base forecast, being developed for 2018 for the purposes of budget financing, economic growth will be only 1.1%. In the Government's opinion, a more substantial growth of the economy, calculated on the basis of a five-year plan for GDP growth, is possible only in the case of accelerated structural reforms. At the same time, the probability of this, in the situation of the actual freezing of negotiations with the IMF and judging by the statements of the authorities, can be considered minimal. The agenda includes only the adoption of a widely announced package of bills to improve the business environment, the details of which remain unknown. Moreover, there is more and more information about the gradual return to the practice of bringing directive plans to state enterprises: both in the area of indicators of economic growth and in the field of wages. The average wages continue to demonstrate significant growth (in May it grew up to BYN 795.2) and to move in the direction of the level of BYN 1000, set by President Lukashenka.

## **The risks of financial volatility**

The main event of the month was the placement of new Eurobonds for a total amount of USD 1.4 billion. The previous time the Government of Belarus entered the market of foreign currency debt in 2011. After that, the authorities repeatedly stated their intention to attract resources through this source and even included it in the annual plan for refinancing the state debt, but in practice this never happened. The current placement is considered as a source of refinancing of 7-year Eurobonds in the amount of USD 800 million, maturing in January 2018. The amount of attracted resources turned out to be USD 600 million more than previously announced, while demand was 2 times higher than the size of the final placement. Perhaps, only its cost, which was significantly higher than the level the government could count on, was disappointing. Thus, with the current yield on Belarus-2018 Eurobonds at 4.5-5% per annum, the value of new placements was 7.125% for five-year securities and 7.625% for ten-year ones. This is also significantly more than the cost of attracting resources in the domestic market - the last dollar bonds of the National Bank were sold at a yield of 4.5%.

Probably, the main factor of such overpayment was the absence of a new loan from the IMF. Earlier, the members of the Government repeatedly stated that the very fact of having a plan for transforming the economy of Belarus agreed with the IMF should lead to a reduction in the cost of investment resources for the country. Accordingly, the entry of Belarus into the Eurobond market without reaching an agreement with the IMF indicates that the authorities are not ready to implement the measures proposed by the Fund. In particular, this concerns the increase in the cost of housing and communal services for the population and, in general, the rejection of the policy of cross-subsidization, as well as implementation of the full-scale system of self-financing for the state enterprises. The fact of suspending negotiations with the IMF has already been confirmed by some members of the Government.

Against the background of problems with the IMF, Belarus promptly received the fourth tranche of a loan from the Eurasian Stabilization and Development Fund (hereinafter referred to as ESDF) for the amount of USD 300 million. In this case, the Belarusian authorities failed to fulfil one of the benchmarks of the measures for this tranche (to refinance the national debt by no more than 75% of the payments), although previously ESDF was more sensitive about the formal implementation of the funded program. Moreover, the representatives of both Belarusian and Russian authorities declare their fruitful work concerning the provision of Belarus with the next Russian intergovernmental loan for the amount of USD 700 million. The allocation of this amount intended for refinancing current payments to Belarus on Russian loans may happen already in July-August 2017.

Attracted and expected external financing allows Belarusian authorities to preserve the country's gold and currency reserves in order to minimize the impact of short-term external shocks and significantly reduces the risks of a currency crisis in the medium term. But at the same time, the risks for sustainability of the national debt and the ability to service it are increasing. As of June 1, 2017, Belarus' external debt has increased by USD 277.6 million since the beginning of the year and reached USD 13.9 billion. Taking into account the borrowings in June, this amount will grow to USD 15.5 billion and will make up more than 30% of the country's GDP. At the same time, the costs of servicing the public debt already exceed 10% of budget expenditures, and further growth of their

share will force the authorities to cut social expenses and expenses for financing the national economy. In addition, despite the observed surplus (5% of GDP in January-May, the situation with the execution of the budget is also far from being excellent. The prolonged fall of the potash market once again forced the authorities to lower duties on the export of potash fertilizers from EUR 55 to EUR 20 per tonne (they were increased to the “normal” level only in January 2017). The deficit of the pension fund, which has to be financed from budgetary subventions, continues to grow: in the fund’s income this source already exceeds a record 12%. The situation should somehow improve in connection with the planned increase in the retirement age, but there are already doubts that the measures taken will be sufficient.

The current situation in the financial sector is still determined by the National Bank’s policy of reducing rates in the money market. In June measures to reduce profitability both in terms of foreign currency (an increase in the norm of deductions to the reserve fund from 11% to 15% and BYN deposits (another reduction in the refinancing rate from 13% to 12% were taken simultaneously. The favorable conditions allowed to take these measures: slowing of the inflation to 6.2% on an annualized basis, maintaining a liquidity surplus in the banking system, a substantial net sale of currency by the population (almost USD 235 million as of May). At the same time, the drop in yield on deposits does not lead to their outflow from the banking system, which can be explained both by the growth of the share of irrevocable deposits, and, in general, by a decrease in inflationary and devaluation expectations. Positive dynamics was also demonstrated by the problem debt in the banking system, which size decreased from 14.2% to 13.6%.

At the same time the loans continue to fall in price: the average rate for new short-term BYN loans for business fell to 13.9% in May (for comparison, in May 2016 it was 27.4%). Decrease in the cost of credit resources level the arguments of supporters of “printing money” policy and reduce the likelihood of a return to the policy of artificial growth of BYN money supply.

### **Conclusions**

The received and expected external financing allows the authorities to solve the problem of refinancing external debt in the short term. At the same time, the very increase in the amount of debt and the growth of expenses for its servicing creates additional risks in the long-term perspective. Long-term risks are accumulating without significant economic growth, and the likelihood of initiating economic reforms aimed at improving the efficiency of the public sector remains low. In the area of economic policy, the authorities continue to concentrate their efforts on creating points of growth at the expense of Chinese projects and obtaining additional preferences within the framework of integration projects with Russia.

