

Analytical Report: July 2013.

Minsk

Crisis in Belarus has continued to grow. Suffice it to say that the modernization of the national economy – one of the main electoral trump cards of Alexander Lukashenko – is stalling. On the 18 July 2013 the Resolution of the Council of Ministers reinforced the responsibility of state enterprises' managers for non-fulfillment of the modernization plans. Given the Belarusian realities, it is possible that the management will become a collective scapegoat if modernization fails or the acute phase of the crisis sets in.

It is interesting to note the protracted silence of Minsk concerning plans for a Russian air base in Belarus. This can be regarded either as evidence of the ambiguous attitude towards the issue in the country's ruling circles, or as the continuation of bargaining with the Kremlin, which needs a "success story" in foreign policy. Attention should be paid to the situation with the invitation of foreign observers to the joint Belarusian-Russian military exercises "West-2013". Moscow initially claimed that the presence of foreign observers is not required and, accordingly, they would not invite anyone, but later at the end of July the information appeared that Russia had invited NATO. Apparently, neither Moscow nor Brussels care about Belarusian opinion on this matter. This is another and rather dangerous sign that the official Minsk has lost subjectivity in international relations.

Although the theme of Belarusian-Chinese relations was popular this month, their real significance for the development of Belarus is low so far. Perhaps it will remain as such. Apparently, the Belarusian authorities were late with the choice of the next strategic partner, because the situation in China is not so easy. According to western researchers, the official Chinese economic statistics has little to do with reality, the current pace of economic growth is overstated by 1.5 times (less than 5% instead of the official 7.4%). The best times for the PRC seem to have passed.

The internal situation: the stability of state power.

The most important events of the month. The most important event of the past month was the cancellation of the European Parliament delegation visit to Belarus. The reason for the refusal was the conditions of the Belarusian authorities.

In July European officials stated that without the release and rehabilitation of political prisoners, the restoration of relations is impossible. These statements ruin the Belarusian authorities' hope that with the help of professional lobbyists, some functionaries of the EU, representing the post-socialist countries and the business community of the "old" EU they will be able to get around the impossible demand of legal rehabilitation. Although in the first half of this year the West seemed to understand that this condition for the regime is unreal.

Meanwhile, the Belarusian authorities demonstrate their interest in selective cooperation in the framework of the EU "Eastern Partnership" program, demanding the abolition of restrictive measures at the same time. The demanding tone of the official Minsk should not be regarded as a sign of power: Belarusian diplomats are very active in the western direction. Despite the holiday season, the meetings and delegations to the EU are rather frequent. However, the effectiveness of the work is not obvious so far.

The development of the situation over the last month. Speaking about the relations between Belarus and the West it is necessary to mention the exemption from punishment of former presidential candidate Uladzimir Nyaklyayew and Iryna Khalip

(the wife of another candidate Andrei Sannikau). Mr. Nyaklyayew and Mrs. Khalip were convicted after the 19 December 2010 events. A number of domestic political scientists regarded the move as a government's gesture towards the West: the reaction to the suspension of the EU entry ban for the Minister of Foreign Affairs Uladzimir Makey. This opinion seems to be incorrect: the fate of Mr. Nyaklyayew and Mrs. Khalip was determined by the stay of sentence execution. The authorities had few options: sending convicts to serve their sentences, penalty delay, or suspended sentence. The acquittal was impossible by definition. One can talk about a gesture of good will only regarding the court decision in 2011. The July court decision to release Uladzimir Nyaklyayew and Iryna Khalip from punishment was merely the formal completion of the process.

On 2-3 July the new president of Venezuela N. Maduro paid a visit to Belarus. Following the meeting with Alexander Lukashenko the need to develop a new "road map" of bilateral cooperation was stated. Proceeding from the earlier official statements, the Belarusian-Venezuelan cooperation has been progressing to the satisfaction of both parties. The demand for its major adjustment only confirms the information about rather complex relations between the two countries. Belarusian participants of joint projects have more than once unofficially said that Venezuelans are very demanding partners, and – given the fact that their requirements are constantly changing after the conclusion of agreements – are also very difficult contractors.

On July 15-17 Alexander Lukashenko paid a visit to China, which resulted in the adoption of the declaration on the establishment of a strategic partnership. Belarusian authorities are hoping that it will bring bilateral cooperation to a format more profitable for our country. However, this format has not yet been developed. It should be specially mentioned that the phrase "The Great China" (that is with a capital letter) has become current again among the officials. Note that with regard to Russia this epithet no longer applies.

Conclusions. The requirements of the official Minsk to unilaterally lift the EU restrictive measures seem out of touch with reality. The official Minsk is not in a position to impose conditions. Despite the significant financial investment through informal diplomacy and lobbying, this inadequacy brings the process of normalizing relations to a standstill. The West got tired of the Belarusian issue, and the relations with our country (which are of little importance to Western policy-makers) can finally lose their significance because of the authorities' conduct. Minsk is far too negligible a quantity for Washington and Brussels to pay attention to its requirements. If it has previously been suggested that the Belarusian authorities will be able to achieve a rapprochement with the West on favorable conditions for themselves due to the influence of their lobbyists, the end of July shows that it is highly unlikely in the near future. The threat of a financial crisis in Belarus is too obvious, and the West can wait. The subjective factor should also not be ignored: the fact that the EU did not respond to insults against a number of European officials from the Belarusian side in due time, does not mean that everyone has forgotten about them.

The strategy of pulling the official Minsk in joint projects, which received certain support in the European structures, does not mean that the existing restrictive measures would be lifted or would not be enhanced. Belarusian officials still do not understand that the West would not play on their terms

Speaking of the Belarusian-Venezuelan relations, it is possible that their peak has passed, and once the Belarusian side will have all engagements under defense contracts met, some recession can be expected. Previously, something similar could be observed in the Belarusian-Iranian contacts.

The adoption of a declaration on strategic partnership between Belarus and China is not likely to entail any significant change in the nature of bilateral relations. Belarus will continue to act as a donor of technology and a consumer of Chinese products. While the Belarusian authorities will seek political advantage, China will continue to take the financial one. Some increase in Chinese aid to our country can be expected. However, given its small size, it will hardly influence the economic situation in Belarus essentially. China will not replace Russia, just as it did not replace the U.S. to Pakistan. President Lukashenko's visit has more propaganda value for the domestic audience and for Moscow. Its practical value is small.

The internal situation: the opposition and the protest movement.

The most important events of the month. The most important event of the past month was the confrontation between residents of several Minsk districts and local officials around the consolidation of urban development. The situation in Minsk is a precedent on a national scale for the residents of major Belarusian cities and local authorities, who often allow the construction not only without consulting the local population, but also ignoring the law. The tough position of local people should be noted: they are willing to defend their own – often selfish – interests even by illegal means. The “European perspective” initiative provides the protesters with expert support. The competent joint efforts of its activists and local residents, based on the existing legislation helped to prevent the consolidation of several micro-districts in Minsk.

The authorities have developed new tactics in combating the “European perspective”. If previously they tried to ignore it, now they send officials or persons who are dependent on the state (public sector workers, lawyers and the like) to the initiative groups of protesters. Those officials accuse the “European perspective” of politicization and encourage local residents to go directly to a public prosecutor or to court. The authorities have chosen the tactics of splitting local initiative groups and directing people’s attention to the formal procedures which do not prevent the construction of facilities – against which the citizens actually protest.

The development of the situation over the last month. The problem of establishing a Russian air base in Belarus remains in the focus of the opposition groups. The Belarusian Christian Democracy (BCD) came out with the strong statement, where they say the establishing a Russian military facility here is occupation policy. Judging by the content of the document, the party is going to take the issue to the international level, enlisting the support of sister organizations in the countries of the former Soviet bloc.

The Belarusian Popular Front (BPF) party has demanded for public hearings on the Russian military base issue. It is doubtful that the authorities consent to it. In case of refusal, the BPF is going to organize informal hearings and to hold a protest action.

The Belarusian opposition continues to prepare for the upcoming elections to the local councils next year. Because of the predictable result, the participation of opponents of the regime will be limited. Thus, the BPF has partially formed a list of activists who will be nominated as candidates. About a hundred party members have expressed their

desire to fight for the parliamentary seat. The party leadership notes the lack of motivation to participate in the elections. However, the BPF is planning to observe the elections together with four other organizations (the “For Freedom” movement, the “Tell the Truth” campaign, the Belarusian Social Democratic Party (Hramada), and the BCD). The observation will be carried out in those districts where the opposition candidates are going to run for seats. The “For Fair Elections” initiative was chosen to be an inter-organizational structure for observation. The ability to cover all polling places in the districts where the opposition candidates will run remains a problem. This will be difficult due to the limited human capacity of the opposition groups.

In July the BCD “People's Deputy” campaign, aimed at solving the problems of local communities, especially those in the regions, livened up. In the absence of real political process, the opposition parties in Belarus are forced into dealing with uncharacteristic issues, actually encroaching on the field of third sector organizations.

The activities of the “People’s referendum” campaign have been going on. The organization leaders involved in the initiative tour the regions of Belarus practically on a weekly basis. However, photos of the meetings in the field show a small number of participants. Of course, the local authorities are not interested in creating conditions for the opposition, which has to use the available premises for the meetings, but they are generally very small in size. However, even these small rooms are not full. Apparently, the main visitors are local opposition activists.

The United Civic Party (UCP) took the initiative to develop a common position of the regime’s opponents on authorities’ foreign borrowing. The main purpose declared is to determine the efficacy of spending the borrowed money. It is planned to develop the necessary recommendations and hand them to international financial institutions. Given the fact that the UCP is one of the consistent opponents of the current regime, it is clear that its main objective is to stop the financial support of the regime by international creditors. In any case, if the UCP can make a quality analysis of spending the borrowed funds, confirming its inefficiency, it can become a serious political argument. But wide participation of opposition organizations in the project cannot be counted on. Previously the UCP put forward a number of initiatives to counteract the sale of state property by the authorities, offering the other opposition organizations to join them. Except for the informal oral support, no fundamental public statements followed.

Conclusions. The weak point of all Belarusian opposition protests against the establishing a Russian air base is the lack of suggesting any reasonable and realistic ways to restore the national defense capabilities. Besides, all statements made are aimed at undefined public, ignoring the military personnel, though they should be the main target audience for any appeals on security and defense. An appeal to their own military would allow the opposition to move the “game” to the authorities’ field, all the more so that the consensus on the Russian base have not been reached.

Given the low motivation of opposition activists to participate in the elections in 2014, the ability of the “Tell the Truth” campaign to nominate 1000 candidates for deputies of local councils (as the leaders of the structure announced a few months ago) is questionable.

The “People’s referendum” is not currently able to politicize the masses of those disaffected with the government. The project is, first of all, an ideological support of local activists. The latter is also very important. In general, even the limited mobilization

of activists in the Belarusian regions is more important for the future of the opposition groups than their regular “gatherings” in Brussels.

Economic situation.

The most important events of the month. July was full of events that will determine the trends in the economy of the country for longer period, than a month. The main one was the panicky outflow of ruble deposits, described in the previous [report](#). The reason for that was the growth of the devaluation expectations due to lower interest rates on ruble deposits in the second half of June, The trend of reduction of ruble deposits was recorded in June (though it was only 0.3%), but it gained considerable strength in early July. Thus, according to the operational data of the National Bank for the first 10 days of July the ruble deposits of about Br 1 trillion (or 4% of all the deposits) were turned into foreign currency deposits. In addition, the demand for cash currency grew as well: only from July 1 to July 10 people have acquired approximately USD 130 million on a net basis, which is slightly less than this figure for the whole of June. The situation was worsened by the fact, in July the next peak of external payments of the country happened and the obligations to be repaid within a month were more than USD 550 million.

Thus, gold currency reserves were under pressure from two sides: from the cost of debt service and from the costs of paying off excessive demand on an exchange, which was agreed to meet in order to prevent a sharp devaluation of the ruble and further spreading of panic.

The development of the situation over the last month. In order to maintain gold currency reserves the authorities were forced to drastically tighten monetary policy by raising the value of money in all market segments. Firstly, just like the previous year decision, taken in response to the worsening of the situation on the currency market before the September elections, standard of accruals on foreign currency deposits had elevated from 12% to 14%. Then the rates on operations to provide liquidity to banks (which actually is a real refinancing rate) were increased from 29% and 35% (depending on the type of operation) to 40%. In addition, National Bank strictly limited the operations to provide liquidity, providing rubles only to a limited extent and only to key banks. As a result, the banking system of Belarus got another crisis of ruble liquidity shortage. Starting in early July with the value of 21-22%, the rates on the interbank market rushed to a level of 60%. A similar increase occurred and the deposit market. If in June the average rate on new short-term ruble retail deposits decreased to 23.4%, in the second half of July rates at most banks soared to 35-36%, and in some cases – up to 44-50%. After a few months the National Bank has extended the provision of liquidity to banks and stabilized the market at the level of 35-40%. In terms of monetary regulator this level should provide a comfortable environment for savings in Belarusian rubles, even in a gradual devaluation.

Thus, of the alternatives to stimulate economic growth and maintain macroeconomic stability the authorities had chosen the second one. The tension in the financial system of the country fell down a little and risks of catastrophic developments significantly diminished. However, it was possible to achieve this stabilization only due to return to the tight monetary policy.

After the threat of a sharp outflow of ruble deposits was localized (deposit outflow was stopped, and the demand for foreign currency has declined significantly), the greatest

concern with regard to the preservation of financial stability in the country is the safety of gold reserves in the medium term. Their size available is sufficient for debt service in the current year, but without major sources of replenishment the problem with a high probability will encounter in 2014. Taking into consideration the fact that significant breakthroughs in foreign trade are not expected (especially due to the deteriorating situation on the potash market, threatening to cut the country's exports by another USD 500-700 million on an annualized basis), plans to privatize are ruined, and relations with the international financial institutions are far from being cloudless, there are not so many options for the authorities. Thus, it is planned to raise about USD 300-400 million in the domestic market before the end of the year, while the placement of currency bonds worth USD 50 million in July failed to be fully implemented even in the situation of the creation of favourable prudential conditions for banks for such transactions. The government has also promised to revisit the issue of the new placement of Eurobonds in September, but the conditions for such a placement are not quite add up until favourable: the current market price of Belarusian bonds fluctuate at face value, which means that yield announcement of starting a new placement at above 9%.

Against this background, President Lukashenko unexpectedly stated that China was ready to give Belarus a loan to replenish the gold reserves and the final terms of the transaction would be agreed at the planned meeting of Prime Ministers of the countries.

Obviously, all previously announced plans to reduce the refinancing rate and the cost of credit by the end of 2013 can be considered to be failed. On the contrary, after the increase of money cost for banks the cost of credit to the economy has inevitably increased (by an average of 10 percentage points), and some loan programs (such as soft loans for housing construction) were completely abandoned. Moreover, taking this opportunity, the National Bank decided to seriously tighten and requirements for banks when issuing them since October 1, foreign currency loans, bringing rates on them too seriously grow up.

Conclusions. There is no doubt that the decisive actions of the National Bank were agreed at the highest level. This is evidenced by the fact that all measures to lower the panic have been implemented immediately after the visit of the President of the National Bank of Mrs. Yarmakova to President Lukashenko, and the very increase in the cost of Belarusian rubles caused no public complaints from members of the Government responsible for the economic growth.

The situation in the money market leaves no chance to even come close to the performance of the plan for GDP growth for 2013. The economic growth of 1.4%, achieved within 6 months may somehow increase by the end of the year for purely methodological reasons (due to the exhaustion of the high base effect of beginning of 2012), but is clearly far lag behind the planned level of 8.5%.

The fear of many experts have not been realized, and the government seems to continue trying to balance on the verge of the preservation of financial stability, if necessary, preventing the sharp warming of the economy. This was one of the reasons to revise preliminary forecast of the Government about the GDP growth in 2014 and to change it from 9.6% to 5.7%.

In fact, the only available source of refinancing debt for the current and next year is the internal and external market sovereign debt, while its potential is quite limited.

Given the fact that no possible China's loan options to maintain gold reserves of Belarus have been made public, there is a certain scepticism about the prospects of its obtaining.

The events of July showed once again that the trust of all economic subjects to the national currency and the actions of the authorities is at an extremely low level and it is possible to maintain financial stability only with high interest rates. This policy has a significant side effect, as it is a serious constraint for business activity and, above all, for the private sector. The investments of the government in the existing economic system for the most part do not give proper results. As an alternative to the structural reforms the authorities propose only modernization (i.e. the activation of the same public investment) and the fight against corruption.

National Security and Defence.

The most important events of the month. Event of the month was Alexander Lukashenko's statement of treachery in the ranks of the KGB. In the words of Belarusian leader, a member of the security forces handed over information to a foreign state, which resulted in "... hurt people working abroad". So far, no additional information is available. KGB itself not commented on President Lukashenko's statement. However, some conclusions can be made now.

Firstly, judging by the fact that what had happened was known from the words of Alexander Lukashenko, the situation is quite serious.

Secondly, based on the words of Alexander Lukashenko of "people working abroad" who suffered, there's a high probability of information leakage from employees of Belarusian Foreign Intelligence.

Thirdly, if the second assumption is true, the traitor, most likely served in the units or external investigation (i.e. was personally acquainted with the scouts) or at the KGB personnel department (i.e. had access to the personal information of intelligence officers) or analytical units (i.e. had access to intelligence information.) There is no other way to explain the leakage of information about employees of intelligence.

Fourthly, Alexander Lukashenko spoke of "the people" in the plural. In this regard, it is possible that the transmission of information abroad was carried out for a long period of time. If the latter is true, the damage of betrayal can be very significant.

The development of the situation over the last month. The main events of the month were connected with the domestic defence industry.

In July the completion of ground and flight tests of airborne defence aircraft "Talisman", intended to protect aircraft carriers from enemy interceptors, was announced. The complex has the technical capabilities to thwart missile attacks, to suppress airborne radar systems (hereinafter referred to as ARS) of enemy aircraft in the search target mode at distances of 5 kilometres or more. New features of "Talisman" allow aircraft MiG-29 and Su-25 (the only model of the national Air Force combat aircraft) remain invisible to enemy aircraft. The manufacturer of the product is "Defence initiative Ltd." In this regard, the prospects of electronic countermeasures of aircraft complex "Satellite" previously developed and produced by "558th Aircraft Repair Plant" and already delivered on arms of CIS member states, are not clear.

On July 25, 2013 a joint meeting of the State Military-Industrial Committee (hereinafter referred to as SMIC) and the State Border Committee (hereinafter referred to as SBC) was held. The reason was the need to resolve the issues of cooperation between the two agencies in the interests of equipping the Belarus SBC with modern weapons, military and special equipment. Further cooperation will be developed on the basis of the plan. The first known result is a new all-wheel drive special MZKT-5002 4x4, created by the order of State Border Committee of Belarus.

Belarusian authorities continued their efforts to promote the products of domestic defence industry on overseas markets.

On July 2, 2013 a working meeting between the SMIC Chairman Huruliou and Deputy Minister of National Defence of Laos Lt. Gen. Phomvihan was held. The parties discussed the development of relations in the military-technical sphere between the two countries.

On July 9, 2013 in Minsk Prime Ministers of Belarus and Bangladesh Mikhail Myasnikovich and Sheikh Hasina agreed to establish a commission on military-technical cooperation and the development of a communication plan for the next 2-3 years.

In July it was reported on the possibility of delivery to Vietnam a large batch of Belarusian mobile solid-state two-dimensional radar with meter range RV-01 "Vostok-E". They allow to detect subtle modern fighters, including developed in China, effectively. According to unconfirmed reports the batch can be as high as 20 units. "Vostok" has proven to be highly effective in Iran, where according to local sources, with its help, Iranian military managed to seize several U.S. unmanned reconnaissance vehicles.

On July 15, 2013 in an interview to the news agency "Xinhua" Alexander Lukashenko said that Belarus and China would cooperate closely in aerospace and military-technical spheres. During the July visit of Belarusian head to the Beijing an agreement between SMIC and the State Administration of Industry and Defence Technology of China on cooperation in the field of aerospace and defence technology was signed. Also the talks between representatives of the Belarusian military-industrial complex and management of the corporation "Great Wall" and Chinese Space International Trade Joint Stock Company "Long March" were held.

Space theme was discussed in connection with the Belarusian-Russian cooperation. Thus, JSC "Peleng" announced plans to participate in the release of 10 spacecraft. 4 of them will be improved version of "BelKA" ("Belarusian spacecraft") with remote sensing of the Earth, created in the framework of development united orbital group.

Last month it was announced that the 4 Divisions of Russian S-300, promised to be delivered last April, would be delivered to Belarus next year. Modification of the complex are not announced, however, it is likely that it will be PMU-1. An important question is whether the missiles for the SAM will be supplied simultaneously with them.

On July 8, 2013 the Regulation on the Department for operational and investigative activities Ministry of Internal Affairs of Belarus was approved. It should be noted that a large part of the document, including the chapter "The main objectives of the Department" and "Functions of the Department of" is secret.

Conclusions. An indicator of the seriousness of the situation surrounding the leak of information from the KGB abroad will become the resignation of one of the Vice-Chairmans of the KGB, who were “inherited” by Valery Vakulchyk (Generals Leanid Dziadkou and Ivan Tertel). Currently, according to official data, there are no changes in the top of KGB.

Current possibilities of Laos and Bangladesh for the purchase of the Belarusian defence products and services are very low, in view of budgetary constraints and because of the weak technical equipment of the armed forces of these countries. They have small numbers of outdated arms. So, the revenue from participation in such modernization will be small. Belarusian defence products’ entering the markets of Laos and Bangladesh will be important above all for the penetration and retention in the regional markets of defence products in South and Southeast Asia, which show strong growth. Problematic aspect is that the strategic “partner” of Belarus - China has territorial disputes with several countries in the region. In this context, the question about the reaction of Beijing on the possible delivery of Belarusian radars to Vietnam and the reaction of the other countries in the region on defence cooperation of Minsk and Beijing remains questionable.

Speaking about the prospects of actually Belarusian-Chinese cooperation in defence and space fields, the high probability that it will result in the “flow of technologies” from Belarus to PRC, should be noted. In this case, Belarus gets nothing substantial in return, except regular assurances of eternal friendship and strategic partnership. Obsessive desire of the official Minsk to make a political union with Beijing on almost any conditions is connected, first of all, with a narrow range of potential allies. Belarusian authorities do not give up the hope to create an atmosphere of competition for cooperation with Belarus in order to negotiate with Russia and the West from a more favourable position.

Currently, there is no clear assurance that the S-300, the delivery of which is scheduled to our country in the next year, will be delivered in the modification of PMU-1. Russia may simply not have such a large number of complexes of this modification.

