

**Analytical note:**  
**Monitoring of the situation in**  
**the field of economic security**  
**(December 2015)**

**Minsk**

## The risk of financial instability

In December the situation with asynchronous devaluations in Belarus and Russia occurred again. As a result of the next fall in oil prices the Russian ruble fell against the US dollar by 9.3%. The Belarusian ruble kept the same relative stability to the currency basket, as a result of which its weakening against the US dollar amounted to only 2.6%. Thus another strengthening of the Belarusian currency to the Russian ruble (this time up to the level of BYR 255) certainly worsens the situation for many exporters, oriented to the Russian market. This situation adversely affects the trade balance, which in the last months has already been deteriorating significantly as a result of seasonal factors, the growth of budget expenditures by the end of the year (including the investment imports) and reduction of exports of potash fertilizers. Thus in November the trade deficit amounted to almost USD 740 million. The deterioration of the situation is also observed in the domestic market: the excess of demand over supply increases, there is an outflow of ruble deposits. In order to avoid a significant reduction in foreign exchange reserves the authorities are actively refinancing the national debt from domestic sources through placement of bonds of the Ministry of Finance and the National Bank.

If substantial strengthening of the Russian ruble against the US dollar does not happen, in terms of the floating exchange rate policy the Government will be forced to proceed with weakening of the ruble against the currency basket. On the one hand, such policy has proven its effectiveness in improving the payments balance and reducing the pressure on reserve assets. On the other hand, it creates significant problems for the budget, banks and the real sector enterprises possessing foreign currency loans.

Mainly due to devaluation of the ruble and the associated rapid reduction in the dollar value of GDP, the size of external debt in comparison with GDP grew significantly (according to the estimations, from 52.6% in 2014 to 75.6% in 2015). This reduces the opportunities to attract new loans and increases the relative cost of debt servicing. For example, in 2016 the largest budget item of expenditures was the cost of debt service (20.2% of total expenditures).

The fall in foreign exchange earnings of the real sector greatly increases the risks of growth of bad assets in the banking sector. According to the official statistics, which adequacy traditionally causes doubt of the IMF, bad debts in the loan portfolio of banks in 2015 increased from 4.37% to 6.71%. The increased payments to service foreign currency loans significantly worsened the financial situation of the Belarusian industry, which led to an increase in outstanding debts. For example, the arrears for gas and electricity has reached BYR 5 trillion (nearly USD 270 million), and the current level of payment for these services in the Minsk region is only 42%.

In this situation the authorities increased the targeted support to the large enterprises. Only in December, it was decided to allocate additional assistance in the amount of USD 5 million to the light industry enterprise “Kamvol” to complete the project on modernization. The projects were drafted on the next saving of the cement, wood and glass industry enterprises. A sensational decision was taken on allocation of BYR 4 trillion aid to the secret enterprises.

In general, the mechanism of such support is reduced to direct payments from the budget, or to issuing by the enterprises of the currency bonds under the state guarantees. Thus, the commercial debt of the enterprises in favour of the banks actually becomes the state debt. A positive aspect of such practice is the lack of emission growth in the money

supply. However, at the same time it leads to a gradual change in the structure of budget expenditures, when social spending is gradually replaced by the cost of maintaining the inefficient enterprises of the real sector. In this connection it will be impossible to use such practice long enough, and in case of preservation of unfavourable external conditions the problem of the real sector recovery through bankruptcy and liquidation of inefficient enterprises will have to be inevitably solved.

The question of sources for financing the payments on external debt servicing remains open. According to the plan of the authorities, based on the amount of these payments and the amount returned from the Russian budget from the oil export fees, the need for additional financing amounts to USD 1.5 billion. The decision to open a credit line of the Eurasian Fund of Stabilization and Development for the amount of USD 2 billion, expected by the authorities in December, was not taken, and the program of activities under the project was sent back for revision. At the same time the Government is optimistic about the prospects for obtaining this loan, which is not true for the loan from the IMF, on the prospects of cooperation with which the officials are expressing more and more restrained opinions. For the fourth consecutive year the authorities have been planning to carry out a new placement of Eurobonds, though after 2011 they never once succeeded to implement it. It is not clear how realistic these plans are for the coming year, although the overall quotation of Belarusian bonds is currently at an acceptable level (the current return on them is about 7.5-7.8% per annum).

### **The risk for economic independence**

Belarus and Kazakhstan did not support the Russia's decision to suspend the agreement on the CIS free trade zone with respect to Ukraine. The decision of the Belarusian authorities is grounded by the fact that Ukraine is its second largest trading partner, and the deteriorating terms of trade would be an additional factor of the negative economic dynamics. At the same time, the authorities are going to monitor the changes in the trade flows from Ukraine and will introduce the protective measures in case of increased competition from the European manufacturers.

In general, after such decisions the EAEC less and less resembles a full-fledged economic union, because they didn't succeed even in creating a single customs zone within its framework. And the idea of a single currency within the EAEC seems postponed for an indefinite period of time: upon the request of the Chairman of the Board of the Eurasian Economic Commission Viktor Khristenko, such a move should not be expected before 2025. At the same time Belarus manages to obtain profit from such alliance: for example, the supply of oil in 2016 has reached a record of 24 million tons, there are high chances of success in the negotiations on lowering the gas prices from the current USD 142 per 1 thous. m. cu.

### **The risk of economic recession**

In the last days of December the authorities still managed to approve the planned documents for 2016. They did not bring surprises and have generally been designed in line with the stabilization policy, as had been repeatedly stated. The emphasis is made on the reduction of interest rates on credit resources (from the current 36% to 21-24%) and the stabilization of inflation at the level of 12% (in January-November 2015 it was at the rate of 10.7%). The execution of the budget is planned with a surplus of about USD 920 million. Herewith, the increase in the banks' claims to the economy is expected at only a

slightly higher level than the inflation rate (14-18%). The growth in GDP and real incomes of the population is expected at a minimum level (0.3% and 0.5%, respectively).

However, even such modest figures may be questioned. Firstly, the authorities forecast on the average price of oil and the exchange rate of the Russian ruble (USD 50 per barrel and RUB 63 per USD) currently appear to be overly optimistic. If the actual price of oil will be significantly less than the planned one, and the Russian ruble, respectively, exceeds the expected value, this would lead to the lost revenue in the budget, reduction of foreign trade and, consequently, a further drop in GDP. Secondly, serious structural problems are seen in reduction of investment demand and the low efficiency of public investments. An example of the latter is the program of the cement industry modernization, as a result of which the enterprises of the sector are constantly shortlisted as the most loss-making organizations in the country.

The solution of these problems in a short-term period under the unfavourable external environment is unlikely, especially without the fundamental reform of the system of state property management and privatization. The only innovation in the field of public sector management of the economy offered by the authorities in 2016 is the introduction of indicators for each level of management to assess their effectiveness. Thus for the newly established Government these indicators are the indicators of planning documents for 2016, for the state administration bodies subordinated to the Government these indicators are the specific government programs, for the heads of the enterprises these indicators are the size of export, return on sales and a number of others. However, the effectiveness of such a model is questionable, at least because of potential conflicts of interests at the different levels of management in the hierarchy. Thus, the refusal of the enterprises to work for stock to improve the earnings indicator will automatically have a negative impact on the performance by the Government of the GDP growth indicator.

In general we may summarize that transition from the announced policy to the indicative planning has not yet happened. The authorities have not yet decided to delegate more authority to the level of the enterprise with concentration by the central authorities on the functions of possessory supervision.

### **Conclusion**

The publicly announced government plans for 2016 did not bring surprises. While maintaining a relatively tight monetary and fiscal policy, the authorities did not dare to start overcoming the structural problems of the public sector inefficiency. Even the previously announced measures, such as a waiver of the government agencies from intervening in the operational activities of the enterprises, the concentration of the government agencies on the function of possessory supervision, the transition from the policy planning to the indicative policy and others, have not been implemented. A combination of such policy with the deteriorating terms of trade (a further drop in oil prices and the Russian ruble exchange rate) make the continuation of recession almost inevitable in 2016.

