

Analytical report:
Monitoring of the situation in
the field of economic security
of Belarus (June 2018)

The risks of financial volatility

The main financial event of the month was the reduction of the refinancing rate from 10.5% to 10%, adopted by the National Bank at the quarterly meeting. This decision of the Bank was quite unexpected. Some analysts forecasted a more restrained cut in the rate by 0.25 percentage points or even a repetition of the decision of the Central Bank of Russia, which kept the rate unchanged a week earlier. However, the National Bank did not support the trend popular in a significant part of the developing countries, which moved to tighten monetary policy against the background of US Federal Reserve rate rising and capital outflow related to it. Thus, the increase in interest rates in recent months occurred in Turkey, Mexico, Argentina, Indonesia, Romania, the Czech Republic and several other countries. The Belarussian National Bank justified its decision by the continuing slowdown in inflation, the annual value of which showed a historic low in May, falling to the level of 4.4%. The actions of the National Bank are facilitated by a relatively favorable situation in the currency and deposit markets. The outflow of foreign currency deposits remains insignificant (-3.13% since the beginning of the year) and does not create problems for banks' liquidity. The size of BYN deposits demonstrates growth above the level of capitalization (+ 9.9% for five months in 2018).

The structure of the population's savings is also improving: in the structure of newly attracted BYN deposits, the share of irrevocable deposits for 2017 increased from 61.2% to 72.2%, for foreign exchange deposits - from 39.7% to 46.1%. Concerns about the gradual exhaustion of the currency surplus factor against the background of the growth of incomes of the population are not justified either: as of May results, the sale of currency by the population showed a record level for the year (USD 710 million), while the net sales grew as well (up to USD 234.7 million in May compared to USD 199 million a month earlier). This allows the authorities to maintain the achieved level of gold and foreign currency reserves, gradually reducing the size of the external debt (minus USD 332 million, or 2% since the beginning of the year). The factor of outflow of foreign capital is also insignificant due to weak development of state and corporate borrowings in foreign markets and a low proportion of non-residents in the structure of deposits.

The high inflationary expectations of the population play against the decision of the National Bank. According to the May polls of the National Bank, the perceived inflation rate was 12.9%, and the expected level for the year ahead is 11.4%. This is significantly higher than the National Bank's forecasts for the annual growth of consumer prices by 5.5%. Moreover, a number of factors can prevent the achievement of this goal: a significant growth potential of regulated prices (including fuel prices), by some estimates excessive strengthening of BYN against RUB, the import of inflation from Russia, which is expected to accelerate after the VAT rate has been raised and other measures have been taken to implement the so-called "new May decrees" of President Putin.

The main risks of reducing the refinancing rate are associated with excessive softening of credit conditions and possible significant growth in credit demand. Strengthening credit expansion can have a destabilizing effect on the balance of payments through the growth of both consumer and investment lending. At the same time, the National Bank has many opportunities to prevent the development of the situation under the scenario described, even without the reverse increase in the refinancing rate: both through informal administrative measures and through the use of

prudential controls. The risks of depositors' refusing from BYN deposits as a result of the expected fall in their nominal yield can be estimated as insignificant. Thanks to the achieved structure of deposits, even the fall of the current real yield is not capable of causing shocking problems with bank liquidity due to the impossibility of early withdrawal of deposits.

The risks to economic growth

The positive dynamics of the economy remains unexpectedly high: GDP growth for 5 months was 4.7%. At the same time, we can state the growing role of domestic factors of economic growth associated with the increase in household incomes (+ 7.4% in real terms for 5 months of 2018) and intensification of investments. According to the estimates, investments in fixed assets in 4th quarter of 2017 and in the 1st quarter 2018 provided 3.9 and 4.5 percentage points of GDP growth respectively. An important factor here was investment lending, the share of which in the growth exceeded the share of public investment. Some experts connect a faster growth in demand for investment loans with the restoration of business confidence in government financial policies and the national currency. In addition, the National Bank's studies show the end of the pessimistic phase of the financial cycle (characterized by excessively cautious investment policy of business) and the transition to the phase of recovery, accompanied with an increase in risk-taking, from the beginning of 2019. Along with the improvement of macro conditions for economic growth, this also means a gradual increase in the risks of overheating of the economy.

In June, the Government announced the first forecasts for 2019, which were quite optimistic. Like in previous years, the authorities are developing 2 options for the forecast: the base for calculating the budget (GDP growth of 2.1%) and the target (+ 4.1%) - estimated growth under the most favorable conditions. In the comments to the forecast they state an increasing role of domestic demand, connected, among other things, with the peak of the construction of Belarusian nuclear power plant.

A key challenge for achieving the planned growth is still the low efficiency of capital distribution in the economy, which is primarily reflected in the low profitability of the public sector and its significant bad debts. At the official level, the problem was stated by the National Bank, which estimated the significant level of bad debts of state enterprises as the main threat to financial stability. According to the estimates of the National Bank, the problem debts of large state enterprises already exceed 14% of the country's GDP and continue to grow. Against the background of improving the current economic situation, the authorities once again postponed the decision of the problem of inefficient state enterprises. The practice of supporting enterprises at the expense of budget funds, prolongation of existing debts and their conversion into the state share in enterprises is maintained. In fact, the privatization program remains frozen: it is limited to sluggish negotiations with investors on individual enterprises. At the same time, polls show that the problem of unequal business conditions with state enterprises is increasingly important for the private sector. If previously the financial instability (weak national currency, high inflation, expensive loans, etc.) was considered to be the main obstacle to business development, now the focus has shifted to institutional problems of equal interaction with the public sector, such as the absence of independent courts, the difficulty in securing contracts and arbitrary treatment of legislation by the authorities.

Against the background of the state's rejection of systemic structural transformations, it is worth noting the growing role of law enforcement agencies, especially the State Security Committee (SSC), in the economy. On the instructions of Aliaksandr Lukashenka, the SSC, and not the State Control Committee and other economic institutions, is increasingly involved in solving economic problems. Thus, in June, one of the most large-scale anti-corruption operations in the history of Belarus was conducted in order to identify the reasons for the high cost of drugs. During the investigation, the SSC officers opened corruption schemes for the purchase of medical supplies for state needs and for the import of drugs into the country. It is noteworthy that the SSC considered the main reason for the development of corruption to be too complicated and bureaucratized system of the Ministry of Health work, actually advocating its liberalization.

The risks to economic independence

After a series of negotiations, Russia abolished restrictions on the import of Belarusian dairy products, at the same time introducing the list of enterprises allowed to the Russian market. This decision was also achieved thanks to the active lobbying of the interests of Belarus through the allied structures. In particular, Eurasian Economic Commission (EEC) took active position in the dispute. The former Prime Minister of Belarus Sergey Sidorsky is the member of EEC. In the process of settlement of the dispute, the Belarusian side actively raised the issue of transferring additional powers to common bodies. The official Minsk seems to see this measure as a mean of strengthening control over Russia's compliance with its obligations. However, the restriction of sovereign rights in the long term certainly increases the risks of increasing economic dependence on the dominant country of the union.

Conclusions

The factor of growth of investment activity and an increase in the propensity of the private sector to take risks in many respects causes the preservation of economic growth at an unexpectedly high level. At the same time, the main deterrent is the low efficiency of the public sector of the economy, and the main risk for destabilizing the financial system is a significant level of its bad debts. Decrease in the refinancing rate also creates additional risks for the financial sector, however, the National Bank has all the necessary facilities for their prompt liquidation, if necessary.

