

Analytical report:

**Monitoring of the situation in
the field of economic security
of Belarus (February 2019)**

The risks to economic independence

Despite the confidence of some Belarusian officials that the issue of compensation for losses from the Russian tax manoeuvre would be resolved in February, the talks between Aliaksandr Lukashenka and Vladimir Putin brought no result. Moreover, according to Lukashenka, the issue of tax manoeuvre has not been discussed at all. Judging by his subsequent rhetoric (in particular, on the “Big Talk” with journalists), the authorities are ready to accept the lack of compensation and to refuse from further attempts to receive it. In this case, one can hardly expect a noticeable warming in bilateral relations. The issue of gas prices for 2020 and subsequent years remains on the agenda, as the gas agreement with Russia expires at the end of the year. In this regard, the Russian pressure on Belarus, manifested in the demands for increased economic and political integration, concessions in terms of the entry of Russian capital into large objects of Belarusian state property as well as targeted bans on the supply of Belarusian products, is likely to continue.

The methods used by the Belarusian authorities to seek concessions from Russia will also apparently remain the same: criticism of the current state and dynamics of integration processes in the EAEU, attempts to intensify relations with the EU and US, reducing dependence on Russian oil. At the same time, Minsk is not ready to make a serious aggravation of relations due to the total dependence of the Belarusian economy on the Russian one. Russia, as before, remains the main trading partner of Belarus: at the end of 2018, its share accounted for more than 38% of exports and almost 59% of imports of Belarus. At the same time, for key non-commodity goods, the share of exports to Russia is absolutely dominant: for example, it reaches 90% for dairy products, 68% for trucks, and more than 50% for tractors. Russian capital is also the main source of foreign investment for Belarus: its share last year accounted for more than 38% of foreign investment in the real sector of the country's economy.

The issue of obtaining Russian credit resources remains extremely important for the Government. Thus, by the end of March, the authorities hope to receive the last tranche of the Eurasian Foundation for Stability and Development (EFSD) loan in the amount of USD 200 million. The Government of Belarus officially appealed to the Russian authorities with a request for an intergovernmental loan in the amount of USD 600 million. The requested amount corresponds to the Belarusian debt service costs to Russian subjects in 2019. The importance of obtaining Russian resources is increasing due to problems with placing panda bond in the Chinese market. Belarusian Deputy Finance Minister Andrei Belkavets confirmed that the received Chinese credit rating of the country does not allow to do this. At the same time, the budget for 2019 foresees the receipt of more than USD 500 million by placing sovereign securities and China was considered as the main market for their issue.

The risks of financial instability

The lack of compensation for losses from the tax manoeuvre automatically worsens the basic scenario of the country's economic development for 2019: the expected growth of the balance of payments deficit will create pressure on the BYN exchange rate and the size of inflation. At the same time, it is too early to talk about any noticeable influence of this factor on the current state of the financial market. The situation in the foreign

exchange market remains favourable and even has shown some improvement in February. The population and non-residents again secured a net currency supply (the population sold almost USD 57 million on a net basis, non-residents - USD 87 million), which allowed the National Bank to replenish its reserves at the expense of the foreign exchange market after a break in January. At the same time, the BYN exchange rate for the month insignificantly (within 0.5-1.5%) strengthened against all currencies of the basket.

The stabilization of the foreign exchange market once again improved the population's inflationary expectations (compared to November 2018 the expected inflation decreased from 12.6% to 11.6%), which also led to an increase in the population's propensity to save in national currency. Thus, in January, a record-breaking positive dynamics in the individuals' deposits market was observed: at almost unchanged rates, a significant increase is recorded both in the BYN (+ 2.3%) and foreign currency deposits (+ 2.2%). The growth of BYN deposits wasn't prevented by the acceleration of the observed inflation, which in January amounted to 0.9% with an annual plan of 5%. The recorded inflation growth was expected and was partly seasonal, as well as other temporary factors like the acceleration of inflation in Russia (in February, at an annualized rate, it reached 5.2%) or a significant increase in household incomes at the end of 2018. According to the National Bank, the influence of these factors will gradually be exhausted and by the second half of the year inflation will fall within the planned limits. In the case of preservation or growth of inflationary processes, the National Bank is ready to resort to raising the refinancing rate to "cool" the money market. The authorities' willingness to resort to this unpopular measure should demonstrate to the market that the interests of maintaining financial stability are now a priority compared to the need to stimulate economic growth.

The risks to economic growth

The statistics of economic growth for the first month of 2019 also turned out to be relatively positive. Although some experts expected the shift of economic dynamics to a negative area, GDP growth was 0.7%. The authorities themselves expected more modest dynamics, forecasting 0.6% GDP growth in the first quarter. It should be noted that one of the factors for such GDP growth was a significant increase in the supply of electricity, gas, steam, hot water (+ 5.2% compared to last year), which is explained by a colder January compared to last year. Agriculture and wholesale trade showed negative result (-1.9% and -0.7%, respectively), while industry is growing at a modest level (0.9%).

Although the Government's plan to achieve 4% GDP growth for the year still looks overly optimistic, the authorities claim that there are reserves to achieve it. In the first place, such reserves, according to the authorities, should be hidden in the increase of the efficiency of the public sector and stimulation of the growth of small and medium-sized businesses. The government is really trying to step up efforts to improve the efficiency of the public sector. Thus, the authorities began the process of building a corporate governance system in state-owned enterprises. The principle of forming a supervisory board in joint-stock enterprises with a predominant share of the state has been revised: if earlier this body was purely formal, now the representative of the state is appointed head of the supervisory board, which should enhance its role in management. In this case, the supervisory boards of large enterprises should be headed by top-level officials. Under the auspices of the World Bank, state enterprise employees are trained in the basics of

corporate governance. According to the authorities, these measures should be the first steps for the state to withdraw from the operational management of enterprises and focus on owner control. The Government also declares the beginning of the process of ranking all enterprises into three groups: those that do not require state assistance, viable with state support and ones that not viable even with state support (source). This step was previously recommended to the authorities by the IMF, considering it as a tool for optimizing measures to stimulate the economy.

At the same time, the political issue of the fate of unviable enterprises has not yet been resolved: the rehabilitation system shows its inefficiency, and the authorities practically do not resort to the liquidation of enterprises. The targeted system of social support of the population, potentially suffering in case of more active use of bankruptcy tools, is not built. In addition, the fall in budget revenues due to tax manoeuvre in Russia leads to a situation where the authorities are already forced to reduce measures to support the public sector, while not reducing administrative pressure on it. Thus, the authorities declare a substantial tightening of the rules for receiving state support in the current year: you can only apply for the state's support if the conditions of its previous grant have been met. In addition, in 2019, the resources of the authorities will go only to refinance the old obligations, and new projects with state support will not be started.

Three new presidential directives, signed in early March, are also surprising. These directives were the first since December 2014, and they address the problems of the development of agriculture, utilities and construction. Despite the sectoral differences, these documents have common characteristics: they actively appeal to the use of administrative measures and there is no mention of planned structural reforms in them. The most odious measures can be found, perhaps, in the directive on agriculture. For example, the directive obliges the Ministry of Internal Affairs to conduct annual checks of the readiness of agricultural organizations to field work (without specifying the form of ownership), regional executive committees – to ensure a sufficient number of stores of grass feed and increase the productivity of the dairy herd. The directive also contains micro-level measures, such as, for example, the obligation of the head of the agricultural organization (again, without specifying the form of ownership) to ensure the presence of a year and a half stock of feed before the start of the winter season. In fact, these directives once again fix the fact of the active participation of the vertical authorities in the operational work of enterprises in the real sector of the economy. This seriously contradicts the stated intention of the Government to reform the public administration system, and makes it possible to seriously doubt the efficiency of the measures taken by it.

Conclusions

Despite the lack of progress on the issue of compensation for losses from tax manoeuvre, the financial situation in the economy continues to be stable. The reduction in the budget capacity forces the authorities to limit state support for the real sector of the economy, while changes in the mechanism of state property management are insignificant. In addition, the content of the new presidential directives indicates the preservation of the administrative methods of management.

