

**Analytical report:**  
**Monitoring of the situation in**  
**the field of economic security**  
**of Belarus (May 2019)**

**Minsk**

## **The risks to economic independence**

Disagreements in relations with Russia still remain unresolved, while their number is only increasing. There is no progress in the matter of obtaining compensation for losses from the tax manoeuvre, although the Belarusian authorities state the continuation of negotiations on this issue at all levels. The Belarusian government was surprised by a delay in issuing the last USD 200 million tranche of the Eurasian Fund for Stabilization and Development loan, despite the fact that all the conditions for its provision were met. There is no clarity about the possible time of receiving the promised intergovernmental loan in the amount of USD 600 million, which is already included in the Russian budget.

A significant shortfall in export earnings due to sanitary restrictions imposed by the Russian authorities is reported by Belarusian manufacturers of dairy and meat products. These already pressing problems are accompanied by the issue of compensation of losses related to the delivery of a significant amount of low-quality oil through the Druzhba pipeline to Belarusian refineries in April. The final size of the damage caused is not yet determined, but according to some estimates it can be from USD 271.3 million to USD up to 435.3 million. This amount is formed from direct losses from damage to pipelines and refineries' equipment, as well as from lost profits due to falling exports of petroleum products and a decrease in the volume of oil transportation. At the same time, the size of indirect losses continues to increase: the Navapolatsk refinery is still working only at 65% capacity, and the output of the Druzhba pipeline at full capacity is expected no earlier than at the end of July.

Judging by the public statements of Aliaksandr Lukashenka, the negotiations on the compensation of these losses promise to be difficult, and Russia is inclined to underestimate the Belarusian losses. The actualization by Moscow of the problem of re-exporting Russian oil products under the guise of thinners and solvents by Belarus that took place in 2011-2012, is quite a sign here. Then the Russian authorities wanted to get USD 1.5-2 billion from Belarus as compensation for budget losses, but these intentions were never fulfilled. Now, almost 7 years after those events, the Russian authorities again raised this issue, this time in conjunction with the amount of damage to Belarus caused by low quality oil.

All of the above problems persist against the background of active negotiations on the further integration of Russia and Belarus. At the same time, Russian officials are already openly stating that the issues of crediting and compensation of tax manoeuvre will not be resolved until there is clarity in integration issues. It is expected that the final program of deepening integration, developed by the intergovernmental commission, will be ready and made public by the end of June. Moreover, its detailed content and existing differences still remain a secret to the public.

## **The risks of financial instability**

In April, a significant deterioration in the external sector was recorded. Its state is traditionally the most important factor of financial stability in the country. Exports decreased by 2.8% compared to last year, and the balance of foreign trade in goods in April showed a record deficit since December 2014 - minus USD 882.5 million. Considering the reasons for this failure (first of all, problems with the supply of "dirty" oil), one should not expect a significant correction of the situation in May. An additional risk for Belarusian exports is associated with a possible revision of the trade policy of

Ukraine by the new President Vladimir Zelensky. The introduction of anti-dumping duties against Belarusian cement producers can be the first sign of such revision. Against the background of the next reversal of oil prices, which occurred in May (the cost of a barrel of Brent oil fell from USD 72-74 to USD 60-62 during this period), the situation on foreign markets also becomes less favourable for Belarusian exporters.

At the same time, the current situation in the financial sector remains controlled: BYN exchange rate against the currency basket strengthened by 1.1%, and the size of the gold and foreign currency reserves exceeded the six-year maximum and amounted to almost USD 8.1 billion. This achievement was made possible mainly due to two factors. First of all, it appears that about USD 300 million, attracted in April by the Development Bank on the Irish Stock Exchange, were redirected to the reserve of the National Bank by placing bonds. Secondly, there was influence of net currency sales by the population (in April it amounted to USD 132 million), which allowed the National Bank to remain a net buyer on the stock exchange.

The accumulated amount of the gold and foreign currency reserves exceeds the level set by the authorities as a planned value for the end of the year by USD 1 billion. In the conditions of unresolved issues with obtaining Russian loans, this amount is a backup buffer for servicing foreign debt. At the same time, the authorities are working on alternative ways to attract resources. Thus, in April, Development Bank made a significant placement of the bonds (this time nominated in BYN) on the Irish Stock Exchange. The size of placement turned out to be relatively low (BYN 210 million), but the very fact of the first placement of BYN assets to the international market is important. Also in April, a memorandum with the Bank of China was signed. There were negotiations to provide a loan in the amount of USD 500-600 million. According to the authorities, they are close to entering the Russian stock market with the placement of sovereign bonds on it in the amount of USD 150 million. At the same time, the next issue of Eurobonds is not planned in the near future due to the high cost of this source. The possibility of coordinating a new program with the IMF is also being considered only in the long term, since the authorities are still not ready to speed up on the issue of reforming the public sector and changing the tariff policy for the population.

Of course, a positive fact is a significant slowdown in inflation - in April, consumer price growth was minimal (0.04%), and the annual inflation rate fell to 5.5%. Such results can confirm the National Bank's estimate that the surge in inflation at the beginning of the year was temporary and, in the absence of external force majeure, the rise in prices by the end of the year should be within the planned 5%. At the same time, the main internal inflationary threat remains the policy of stimulating the income of the population. The size of the average salary in April reached BYN 1073 and again exceeded the level of USD 500. At the same time, the government particularly focuses on problem organizations. The intention is to reach the situation, when there will be no enterprises with an average salary below BYN 400 by the end of June.

### **The risks to economic growth**

Economic growth in the country continues to accelerate slightly, and in first 4 months of 2019 the increase in GDP was 1.4%. At the same time, the growth components remain the same: retail trade shows a significant increase (+ 5.9%), industrial production growth remains sluggish (+ 1.2%), while the agricultural sector continues to fall (-0.6%).

The basis of the observed dynamics of the economy is still connected with the growth of incomes of the population, amounting to 7.3% in the first quarter.

Given the more favorable weather conditions compared to last year, the authorities plan to further accelerate economic growth to 1.8% in the first half of the year. The expectations of the Government regarding annual results do not change either: economic growth should exceed the average world level and amount to 4%.

At the same time, several factors can immediately impede the implementation of the plans of the authorities. Thus, the government put a substantial (by 5.4%) increase in exports in the basis for the planned growth. However, at the moment the plans for the growth of foreign demand are not coming true: the size of exports is reducing, significant losses from problems with poor-quality Russian oil are expected, the situation on world markets remains tense. The government is trying to solve the problem of export with disciplinary methods, but, given past experience, they are unlikely to be able to provide the desired result in an unfavourable situation.

The low efficiency of the public sector is still a significant constraint for the development of the economy. According to the review of the World Bank, the medium-term growth potential of Belarus remains low largely for this reason, as well as due to unfavourable external conditions. According to WB estimates, GDP growth in Belarus will be 1.8% in the current year, 1.3% in 2020 and 1.2% in 2021. At the same time, even these indicators are possible only on condition of receiving compensation from Russia in the amount of at least half of losses associated with the tax manoeuvre. At the same time, the WB experts point out that even positive measures by the Belarusian authorities to create favourable conditions for business and the rapid growth of the IT sector cannot globally correct the situation. The private sector inevitably faces the problem of unfair competition with the public sector for limited resources (finance, labour, raw materials), which significantly limits its growth potential and increase the efficiency of the economy as a whole.

In name, the Belarusian authorities truly recognize the problem of the low efficiency of the state sector and consider its solution to be the most important condition for accelerating the economy. However, in practice, the policy to preserve the existing industry structure with the implementation of only cosmetic changes that do not affect the fundamentals of the system continues. A striking example is the cement industry. After the state modernization program worth USD 1.2 billion, the state enterprises continue to generate significant losses from year to year (for example, in 2018 they amounted to BYN 220 million). However, the authorities do not raise the issue of restructuring these enterprises and in April once again decided on their financial support in the form of regular tax incentives, delays and installments for the repayment of loans for a period up to 2049.

### **Conclusions**

The dynamics of the economy and the preservation of financial stability, as before, largely depend on the resolution of issues in relations with Russia and the coordination of a program to deepen integration. At the same time, despite a significant deterioration in foreign trade due to the supply of low-quality oil by Russia, the situation in the financial sector remains stable. In the area of reforming the public sector, the government has not yet turned to the practical implementation of the stated intentions.

