

Analytical report:

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

The risks to economic independence

In September, for the first time, albeit not from official sources, some details of the plan for deepening integration within the so-called “Union State of Russia and Belarus” became known to the general public. So, according to the publication of the Kommersant newspaper (which is close to the Kremlin), the integration program discussed by the authorities provides for such steps as the unification of the tax systems of the two countries, the formation of a single customs policy (up to the creation of a single customs service), the adoption of a common civil code, unification of banking supervision. The document also provides for the creation of a single regulator of gas, oil, oil products and electricity markets, harmonization of industrial and social policies as well as other measures. At the same time, the creation of additional supranational bodies, the introduction of a single currency and the unification of central banks, as well as the formation of a unified budget system are not on the agenda. Although officially the Belarusian authorities did not confirm the accuracy of the published data, the comments of the officials following the publication leave no doubt about the reliability of the sources of the Kommersant.

Among the proposed areas of integration, the most sensitive one for the sovereignty of Belarus is the adoption of a common tax code, which, on the proposal of the Russian side, should happen by April 1, 2021. The tax systems of Belarus and Russia at the moment are quite similar (the composition of key taxes and their rates coincide to a large extent), but at the same time, administration practices and approaches to taxation of individual segments of the economy (for example, small business) are still significantly different. The painless transformation of countries’ tax systems in such a short time seems a difficult task, creating significant risks for economies (from the budget to economic growth). Undoubtedly, the most optimal scenario for Russia is the maximum preservation of current legislation, forcing the Belarusian authorities to make amendments. In turn, for Belarus this will mean abandoning an important instrument for regulating budget revenues and the structure of the economy. In general, there is a question why the merger of tax systems is first on the agenda (for example, within the EU, this problem had not been solved). The task of combining tax systems for economies with a different structure looks, on the one hand, too complicated and fraught with significant risks, and on the other hand, not creating additional gains for integrable economies. In this situation, it is difficult to explain such plans with anything other than a political background.

At the same time, the Russian authorities still keep all negotiations on financial issues suspended, in spite of the fact that the prime ministers of the countries initialled a package of documents on the development of the “Union State”. There is still no decision on the allocation of the promised intergovernmental loan in the amount of USD 600 million, while the issuance of the last tranche of the EFSD loan in the amount of USD 200 million is unreasonably delayed. Apparently, the gas price agreement is postponed until December. It is possible, that it will be valid only until 2020. There are no shifts in the issue of compensation for losses from the tax manoeuvre (the size of the losses for the Belarusian economy has already exceeded USD 240 million).

In such a situation, the Belarusian authorities are trying to put pressure on Russia, while avoiding high-profile conflicts. So, the Belarusian Government has updated the issue of finding alternative oil suppliers for Belarusian refineries. Negotiations with

Kazakhstan are in the final stage, the potential supply of oil from there can be up to 3.5 million tons per year (source). In addition, Aliaksandr Lukashenka promises to consider the option of delivering oil through Polish ports with the involvement of the Druzhba pipeline for this. The practical implementation of such an idea threatens Russian oil companies with both a decrease in demand from Belarusian consumers and a reduction in transit opportunities. According to Foreign Minister Uladzimir Makei, Belarus may even refrain from signing the integration plan on December 8, if the issues of bilateral relations that are painful for it remain unresolved.

The risks of financial instability

The current situation in the financial markets of the country continues to be characterized by stability with sluggish positive trends. Thus, the situation in the foreign exchange market remains favourable for the authorities: as before, citizens remain net sellers of foreign currency (USD 91 million in September), providing its total excess in the market. Against the background of the continuing increase in BYN deposits of the population (+ 2.8% in August), rates on the deposit and credit market demonstrate a further decrease. So, from September 1, the largest bank in the country, Belarusbank lowered interest rates on its loans for residential real estate, as well as on some consumer loans. It is noteworthy that the noticeable fluctuations of the BYN against the USD over the past few months did not have any noticeable effect on the foreign exchange and deposit markets, although previously the high sensitivity of the population to such changes was one of the headaches of the authorities. Consumer inflation remains at a historically low level. Although its current size still exceeds the planned 5-percent threshold (5.9% year on year in August), core inflation has been holding at 4.7-4.8% for three consecutive months.

Although at the end of September, official statistics recorded a slight decrease in gold and currency reserves (by USD 60 million to USD 8.83 billion), their size remains significantly higher than the authorities plan for the end of the year. In addition, the decrease in reserves is largely connected with the fall in the value of gold in world markets. At the same time, the external public debt, despite some growth in August, since the beginning of the year has cumulatively been showing a decrease both in nominal terms (by 1.9%) and relative to the country's GDP (from 28.4% to 27.3% of GDP). Despite the losses to the budget revenues due to the Russian tax manoeuvre, the authorities continue to execute the budget with a surplus (over 8 months its level amounted to about 3.6% of GDP).

The success of the authorities in financial stabilization was also noted in the review by the S&P rating agency, which confirmed in September Belarus' credit rating at "B" with a stable outlook. At the same time, the main risks of the worsening situation in the economy are associated with the lack of agreements with Russia on compensation for the tax manoeuvre (the agency still considers reaching such an agreement in the future as the base scenario), the maintenance of a significant amount of bad debts in the banking sector, as well as a significant share of foreign borrowing in foreign currency (in particular, this applies to 98% of the external public debt).

The risks to economic growth

The situation in the real sector of the economy remains stable, which, however, can no longer please the country's authorities. So, according to the results of January-August,

official statistics showed a nominal slowdown in economic growth to 1.1% compared with 1.3% a month earlier. Such a slowdown is purely methodological and is associated with the exhaustion of the factor of early harvesting in the current year compared to the last one. Because of this, output growth in agriculture for January-August formally slowed down from 5.6% to 2.8%. The largest contribution to the achieved GDP growth was made by the information and communication sector (in fact, the country's IT sector), which accounted for 0.5% of the 1.1% growth. The contribution of other sectors was less significant (industry yielded 0.2% growth, construction, trade and agriculture - 0.1% each, transport sector was negative - minus 0.1%).

Thus, the Government is getting closer to the failure of plans for 2019. Currently, 3 out of 7 benchmarks are not implemented, including 4% GDP growth. Such a situation in the country's economy during the pre-election period has already caused sharp criticism from Lukashenka. The latter even promised to dissolve the Government if the forecast for the current year is not fulfilled. The Government's policy documents for 2020, which envisaged 2.5% GDP growth and the transition to budget deficit execution, did not receive the highest approval. Aliaksandr Lukashenka criticized the Government's focus only on macroeconomic stability without a significant improvement in the standard of living of the population. The plans of the Council of Ministers were declared "insufficiently tense" and sent for revision.

Moreover, the Government's forecast for GDP growth for 2020 at the level of 2.5% can be called quite optimistic. The latest estimates of international organizations (from the IMF to S&P) determine the potential for economic growth in Belarus at about 2% (this is only in case of compensation for losses from the tax manoeuvre in Russia). The low efficiency of large-scale public sector is key weakness of the economy. Formally, the Government recognizes this problem, but there is still no political solution to the comprehensive changes. In this regard, the authorities' ongoing work with the World Bank to develop a roadmap for improving the efficiency of the economy is not encouraging. So, according to representatives of the World Bank, there are significant disagreements with Belarus on issues like tariffs for heat supply, reform of state enterprises, subsidies, and directed lending.

At the same time, external conditions for the Belarusian economy are getting worse. World economic growth continues to slow down, and the risks of the recession in the US and EU economies are gradually increasing. Thus, leading indicators of industrial activity dropped to the lowest levels in recent years. It is significant that this is happening against the background of soft monetary policy. So, rates in the EU remain at a historically minimal level, while the ECB continues to implement a quantitative easing program (in fact, active emission of the Euro). At least in the short term, Brexit without an agreement, which has all the chances to happen already on October 31, may also become a negative shock to the European economy. The global threat to the world economy is the protracted trade war between the United States and China, which, according to the IMF, will cost the world economy USD 700 billion, or 0.8% of world GDP in 2020. In such a situation, the only option for the Belarusian authorities to revitalize the country's economy in the short term is only to actively increase state investment spending. However, such a policy is traditionally accompanied by a sharp increase in risks for the balance of payments, public debt and budget.

Conclusions

The key issue on the current agenda is still integration negotiations with Russia. Their successful completion should be an additional incentive for economic growth and a factor in maintaining financial stability amid worsening external conditions. At the same time, deeper integration creates significant threats to the economic independence of Belarus.

