

Analytical report:
**Monitoring of the situation in
the field of economic security
of Belarus (October 2020)**

The risks of financial instability

In October, the negative trends in the financial market, provoked by the internal political crisis, weakened but remained stable. The key problem is a significant outflow of deposits from the banking system, caused by a crisis of confidence and high devaluation expectations. Thus, the decrease in foreign exchange savings of the population in the banking system (deposits and funds in accounts) in September amounted to almost USD 470 million. In annual terms, the outflow of fixed-term foreign currency deposits amounted to 20%. The situation with BYN deposits of the population was developing more favourable: in September they declined only by 1.65%. However, judging by indirect signs, by the end of the month the outflow of deposits accelerated in this segment of the market. In late October and early November, many banks simultaneously raised rates on short-term deposits by several percentage points to 20-22%. The increasing inflation, the level of which in October amounted to 6.2% in annual terms, is also reducing the attractiveness of BYN savings. According to Ministry of antimonopoly regulations and trade associates such an acceleration in consumer prices with BYN weakening and the rise in prices for imported goods. At the same time, the growth could have turned out to be more significant, if not for the historically minimal growth of regulated prices (only 5.6% in annual terms), achieved by strengthening their administrative restraint. At the same time, judging by the public statements, the authorities also allow further acceleration of inflation, up to the level of 10%.

One can observe a formal improvement in the foreign exchange market. At the end of October, a significant excess supply was recorded on it. It was formed primarily due to the sale of foreign currency by organizations. The sale on a net basis amounted to more than USD 300 million with a net demand from the population in the amount of about USD 90 million. As a result, the purchase of foreign currency by the National Bank on the stock exchange became one of the sources of financing for payments for servicing the state debt, which allowed the National Bank to ensure the growth of gold and foreign exchange reserves at the end of the month. Such a favourable situation for the authorities is largely due to the tax period, during which organizations are forced to sell foreign exchange reserves to pay taxes. In the coming months, the situation promises to be less favourable, since a period of seasonal growth in imports is expected ahead, associated with both New Year consumption and additional financing of budget expenditures. The growth of the gold and foreign exchange reserves to the level of USD 7.49 billion, recorded after 2 months of their significant decline, does not cause much optimism. Despite receiving a loan from EFSF in the amount of USD 500 million in October, the increase in reserves for the month amounted to only USD 164 million. In such a situation, the task of preventing the gold reserves from falling below the level of USD 7.3 billion at the end of the year looks quite tense. Currently, the authorities have no planned sources of significant external funding. The timing of the allocation of the first tranche of the interbudgetary loan by Russia remains unknown, moreover, lending will be carried out in Russian rubles, which are not included in the gold and foreign exchange reserves. It is also difficult for the authorities to count on attracting untied Chinese loans, since China has recently tightened its provision of financing to other countries. For example, China has already refused the Belarusian authorities to write off a loan in the amount of USD 230 million, used to finance the program for launching a Belarusian satellite. According to some reports, China is also refusing to build 2 large sports facilities (a national football stadium and a swimming centre) free of charge, offering to implement these projects with tied loans.

In such a situation of uncertainty, the National Bank again extended its decision to suspend operations to provide liquidity: this time for 3 months until January 19, 2021. At the same time, manual methods are increasingly used to manage the banking sector: for example, the National Bank has changed the form of an auction to provide liquidity (instead of a bidding tender, an auction with a fixed rate is used), anti-crisis loans are provided to individual banks (mainly state-owned) in a non-public mode. The refusal of the National Bank to raise the

refinancing rate is also indicative, despite the fact that its real level (excluding inflation) has decreased to a minimum and does not compensate for the risks on BYN assets. This decision of the National Bank is due to the fact that this instrument has ceased to play a significant role in regulating the banking market, becoming more of a benchmark for budgetary policy.

The expected deterioration with the execution of the budget is also observed: at the end of September, there is a sharp increase in its deficit, which has practically reached the level of BYN 2 billion. The main budgetary problems are associated with a reduction in income from income tax and from foreign economic activity (these types of income for 9 months were fulfilled only by 40% and 57%, respectively). As a result, total budget revenues decreased by 5.7% compared to the previous year, even in nominal terms. At the same time, budget expenditures show an increase of 9%. In addition, the increase in pensions by an average of 5.4% announced for December 2020 will aggravate the situation for the budget.

At the same time, the fears about the start of large-scale emission stimulation of the economy, widely expressed in the press, have not yet been confirmed. On the one hand, the authorities really carry out operations with the “top secret” stamp to support specific banks and enterprises. But at the same time, macroeconomic indicators do not yet record the formation of noticeable imbalances. In September the debt of the economy on loans even decreased slightly (by 0.37% for BYN loans and by 2.42% for foreign currency loans), although inside it there was a redistribution in favour of public sector enterprises (it is the latter that increase debts to banks, while the private sector is cutting them). There is also no significant growth in BYN money supply: + 3.3% in September, while a decrease of 8.5% since the beginning of the year.

The risks to economic growth

Despite the difficulties in the financial sector, the dynamics of GDP has stabilized, and for the second month in a row its fall against the level of the previous year remains at the level of 1.3%. Agriculture, construction and the IT sector remain the main drivers of the economy. A certain role is also played by the increase in stocks of finished products in industry: at the beginning of October, their level was 68.5% of the average monthly production, which is their maximum value for October over the past 5 years. This policy makes it possible to somewhat mix up the weakening of external demand, but requires additional financial investments from enterprises. As a result, the economy of Belarus shows the smallest decrease in the region, and at the same time the authorities are voicing optimistic plans to reach zero growth by the end of the year, which implies a sharp acceleration of economic activity in the last months of the year.

However, the possibility of such a scenario, given the emerging external and internal factors, looks unlikely. Thus, the second wave of the COVID-19 coronavirus pandemic is already leading to the introduction of restrictive regimes in the EU countries, which negatively affects demand in the global economy. Short-term expectations are also deteriorating in the Russian economy, as evidenced by the reversal of leading indicators. Thus, the Russia PMI Composite index, which characterizes the total output in industry and services, fell from 53.7 in September to 47.1 in October (a value of more than 50 indicates an increase in output, and less than 50 indicates a fall). Domestic economic factors (including related to the current political crisis) will also have a restraining effect. A sharp decline in the availability of credit resources, as well as a shortfall in budget revenues will negatively affect the construction sector. The factor of a good harvest will gradually be exhausted: already by the end of 9 months, the growth in agriculture has slowed down from 7.9% to 4.9%, although earlier the authorities counted on its annual growth at 5.5%. It may also be difficult to continue the practice of building up stocks, since a significant part of state-owned enterprises traditionally have a chronic problem of shortage of working capital, which will become more and more difficult to form in the face of deteriorating credit conditions. Negative trends began to be visible in the export of IT services: the growth slowed down significantly in August. Under such conditions, according to the IMF's October forecast, the fall in the Belarusian economy in 2020 may reach 3%. At the same time,

recovery growth next year is expected at 2.2%, which will not compensate for the observed decline.

The government of Belarus also expects recovery growth in 2021, which should be based on the growth of household incomes and an increase in investment (while its estimate is not so optimistic: GDP is expected to grow by 1.8%). The authorities declare their intention to start a new investment cycle, which, according to the Government's idea, in addition to a direct increase in GDP, should play a role in increasing the investment attractiveness of the country. Prime Minister Raman Halouchanka declares the need to generally raise the level of investment in fixed assets to 25% of GDP. According to the authorities' estimates, this should lead to an acceleration of economic growth in the country and ensure an annual economic growth of up to 6% by the end of the five-year period. As part of this policy, the authorities plan that investments in fixed assets in 2021 will amount to BYN 34 billion, of which 75% will be directed to modernization and creation of new industries. The sources of financing for investments should be enterprises' own funds, bank loans, as well as budgetary resources. However, with respect to each of these sources, there are serious limitations that call into question the possibility of such growth. Thus, the financial position of most of the public sector remains difficult, the level of profitability is extremely low, and the amount of profit is declining. In turn, the increased political risks reduce the attractiveness of investments in the national economy for the private sector. Rising rates and tougher conditions for access to bank loans reduce the attractiveness of this investment instrument as well. The ability of the authorities to maintain the current level of budget spending for investment purposes in 2021 is also questionable. According to the voiced estimates, the authorities are planning a budget deficit of 2-3% of GDP for the next year. One of the sources of financing this deficit is the accumulated balances of previously unspent funds (according to the authorities' estimates, they exceed BYN 6 billion). However, the possibility of using these resources by the government is limited: part of the funds is kept in the foreign currency accounts of the National Bank and is included in the gold and foreign exchange reserves, respectively, their spending will lead to a reduction in foreign exchange reserves. Another part of the funds is placed in state-owned banks, and most likely have already been used by them for current lending activities. In such conditions, the government is increasingly tempted to use emission resources to "speed up" the economy.

In addition to the issue of funding sources, there is also issue of the existence of investment projects. The portfolio of such projects, according to some information, has not yet been formed by the Government.

The risks to economic independence

Resolving the key issues in relations with Russia is still on pause. So, despite the optimism emitted by Belarusian officials, there are no details about negotiations on the gas price for 2021. The timing of granting the announced loan from the Russian government is also questionable. Despite the announcement of activation, work on roadmaps for deepening integration within the Union State remains frozen. The issue of the future common market for energy products in the EAEU remains unresolved. This topic is actively promoted by the Belarusian authorities in the developed strategy for the development of this organization.

In turn, Belarus is in no hurry to fulfil the promise to redirect commodity flows (primarily oil products) from Lithuanian ports to Russian ones. This is justified by the need to agree on more favourable conditions for transportation rates and services.

Conclusions

The persistence of the political crisis is accompanied by an increase in risks in the financial sector associated with the outflow of funds from the banking sector and the sufficiency of resources to service the public debt. Partial mitigation of these risks by limiting lending

activity reduces the potential for economic growth. The authorities' desire to accelerate the economy by increasing investment creates preconditions for new failed investment projects and a return to the practice of emission stimulation of the economy.

