

Analytical report:
Economic security of Belarus
(February 2021)

The financial instability risks

In February, we noted new details of the authorities' operation to rescue Belarusian Steel Works, which was on the verge of defaulting on bonds worth more than USD 600 million. Thus, in addition to re-registering part of the corporate debt into government debt (which in principle is an acceptable option for banks), the authorities also forced banks to for a number of concessions, including writing off part of the debt (corporate bonds are converted into government bonds with a 15% discount), transferring part of the foreign currency credit debt to BYN debt (this will affect debt in the amount of USD 400 million with an extension of repayment until 2050), as well as the exchange of debt for shares of the enterprise (in the amount of USD 350 million). The Belarusian Steel Works case can be an example of how the government intends to solve similar problems of other state-owned enterprises in the future. It is obvious that the Belarusian authorities have chosen a strategy of preserving enterprises in traditional sectors of the economy while covering their financial needs at the expense of banks and the budget. Such a policy leads to an increase in the domestic national debt (in January it grew by almost 18%), and also increases budget expenditures. It is possible to speak unambiguously about the accumulation of risks in the banking system, as well as the formation of conditions for a further decline in confidence in it. At the same time, since troubled enterprises are not subject to the reorganization procedure, the sources of bad debts are not eliminated.

So far, there are no signs of the restoration of savings processes in an organized form, which the authorities clearly hoped for as the political situation in the country stabilized (or, more precisely, froze). At the end of January, the outflow of foreign currency deposits of the population continued (by USD 64 million, or 1.4%). The nominal increase in BYN deposits recorded was significantly less than the size of capitalization (less than 0.3%). The situation of net purchases of foreign currency by the population also persists: in February it amounted to more than USD 47 million.

Taking into account the current political situation, we can talk about the growing risks of easing budget and monetary policies. Thus, the government has already revised plans for the state budget deficit, expanding it from BYN 4 to BYN 5.6 billion. The state media are actively promoting the arguments of supporters of increasing credit support for the real sector of the economy, including on preferential terms. In February, in addition to directors of state-owned enterprises, this position was publicly voiced by such a heavyweight of the state vertical as the head of the State Control Committee. Apparently, under the pressure of supporters of a more active credit policy the National Bank at the next meeting on monetary policy was forced to postpone the decision on the refinancing rate for a month. It is noteworthy that efforts to ease monetary policy are observed against the background of accelerating inflation. Thus, the increase in consumer prices in January accelerated to the level of 7.7% and almost equaled the current value of the refinancing rate, which is 7.75%. At the same time, the National Bank has so far managed to largely restrain the growth of money supply in the economy. For example, at the next auction to provide liquidity to banks at a fixed rate of 9.75%, the National Bank satisfied applications for a total of BYN 200 million of the total applications for BYN 2.122 billion.

There is a question of the sufficiency of resources to service the public debt. Of all the expected sources of refinancing the external public debt, the authorities currently rely only on the next tranche of the Russian loan in the amount of USD 500 million, which is

expected to be received in the first half of this year. On the eve of the February meeting of Lukashenka and Putin, some media outlets reported that the Russian side is ready to provide a new loan in the amount of about USD 3 billion. It is assumed that this amount can be allocated from the unspent balance of the previously agreed loan for the construction of a nuclear power plant (according to the Belarusian authorities, they have used only about USD 4.5 billion out of the allocated amount of USD 10 billion). However, this information was not officially confirmed, and there is no specifics about the possible terms and conditions of such a loan. In such a situation, the country's gold and foreign exchange reserves are the main source of servicing the state debt. Thus, in February, they continued to decline (minus USD 89 million, or 1.2%).

Sufficiently favourable foreign trade conditions can be considered a positive factor for maintaining the stability of the financial system. Thus, statistics have consistently recorded a positive balance of current operations. By the end of January, a small positive balance in trade in goods was recorded. The observed positive in the commodity markets, in particular, the growth of oil prices above the projected levels, also favourably influences the country's balance of payments. In early March, oil cost approached USD 70 per barrel of Brent, while the estimated figure in the Belarusian budget is USD 40 per barrel of Urals on average per year. This dynamics of oil price is facilitated by both fundamental factors (recovery in demand as the pandemic weakened), as well as the new OPEC agreement, and the monetary policy of developed countries to support domestic demand.

The risks to economic growth

At the end of January, the official statistics recorded the expected economic growth against the background of the low base of January 2020. Thus, the country's GDP increased by 1.3%, and the main drivers of such dynamics were the manufacturing industry (an increase of 8.4%, which is due to a more complete utilization of oil refining), as well as the production of heat and electricity (an increase of 13.4% due to a relatively cold winter). At the same time, even according to the expectations of the authorities, these factors will gradually be exhausted, and the projected GDP growth in the first quarter will be 0.3-0.5%. The dynamics in other segments of the economy is much less pleasant. Retail trade continues to stagnate (minus 0.9%), which may signal the exhaustion of growth in domestic demand due to an increase in household income. The minimum growth was also recorded in agriculture (0.3%), which makes it possible to assess the actual dynamics of the industry without the factor of a good harvest in 2020.

During the so-called "all-Belarusian people's assembly" the authorities have outlined a model of economic development, due to which it is planned to ensure a significant acceleration of the economy in the next five years. So, the key points of this model should be the stimulation of domestic consumption, increasing incomes of the population, import substitution and state investment programs. The authorities are talking about the launch of the so-called "new investment cycle" with a total investment of about BYN 200 billion (for comparison, for the period 2006-2020, the investments in fixed assets amounted to BYN 122 billion). In essence, the authorities' plans are much like the program to support the economy after the 2008 crisis. Then the authorities also relied on domestic demand (in particular, through the expansion of housing construction), as well as state investment programs. The risks of such a policy are obvious - the unbalanced growth of household income as well as domestic consumer and investment demand

traditionally sharply worsens the country's balance of payments, creates pressure on the foreign exchange market and intensifies inflationary processes. Any successful implementation of such a model can only be forecasted if external sources of financing for it are found (which will be accompanied with a significant increase in the national debt).

At the same time, the current decisions of the authorities clearly show political motivation to the detriment of economic expediency. The task of preserving and sometimes even reviving Soviet factories remains fundamental for the authorities. A striking example of such a policy is the case of Minsk Motorcycle and Bicycle Plant. The next meeting regarding its fate took place in early March. The attention of the authorities to the development of this enterprise is completely disproportionate to its scale (currently the company employs only 130 people) and potential (the authorities count on the entry of an actual new manufacturer into a highly competitive low-margin market). Political motivation also explains the actions of the authorities to support enterprises, which are the result of failed state investment projects of previous years.

We can also talk about a noticeable increase in administrative pressure from the authorities on the private sector. The most striking step by the authorities in this direction was the decision to freeze prices for a significant part of consumer goods, as well as the introduction of a mechanism for their strict control. So, starting from March, an increase in prices for a wide range of goods by more than 0.2% per month, must be agreed with the authorities by manufacturers, wholesalers and retailers. A significant tightening of the operating conditions is also announced for small businesses: the authorities propose to significantly revise taxes and strengthen administrative requirements. Once again, the officials voice the goal to eradicate intermediation, which, according to the authorities, stimulates additional price increases.

The risks to economic independence

Despite some fears, the meeting of Lukashenka and Putin, held on February 22, ended without loud announcements regarding further integration within the framework of the so-called "Union state". Moreover, according to Lukashenka's statement, the number of roadmaps requiring approval has even increased. If earlier it was said about the completion of work on 28 out of 30 maps, now the need to agree on 6-7 out of 33 integration roadmaps is noted. A little later, the Belarusian authorities voiced the desire of the Russian authorities to step up work on the unification of the tax system, for which the Prime Minister of Russia Vladimir Mishustin, who previously headed the tax department, may pay a working visit to Minsk.

At the same time, it can be expected that under the current conditions the Belarusian authorities will be more inclined to compromise on issues important to Russia. An example of softening the position can be the signing of an agreement on the redirection of a part of Belarusian oil products exports from the Baltic to the ports of the Leningrad region, which the Russian authorities had previously sought for more than one year. Belarus undertook to transport through Russian ports 9.8 million tons of oil products for the period 2021-2023. Already in March, the supplies began to be carried out along this route. In addition, Russia began to voice a desire to transport Belarusian potash fertilizers according to this scheme as well. The economic feasibility of such a transportation route has not been officially disclosed, although according to some sources it is accompanied by additional costs for Belarus in the amount of USD 10-15 for each ton of oil products.

But even in the case of comparable economic conditions, such a decision of the Belarusian authorities is a step towards increasing dependence on a formal ally.

Conclusions

The economic policy of the Belarusian authorities is increasingly determined by political motivation. The government is expanding its use of manual administrative practices. Amid accelerating inflation, there is an increase in the position of supporters of monetary policy easing. The chosen strategy for resolving the debt problems of large state-owned enterprises creates significant risks for the country's financial system in general and the banking system in particular.

