

Analytical report:
Economic security of Belarus
(May 2021)

Minsk

The risks to economic independence

The key factor creating risks for the country's economy is the foreign policy conflict with Western countries. The dynamics and scale of this conflict are growing due to the scandal with the Ryanair airplane landing in Belarus. In response to the actions of the official Minsk, the EU Council closed the European airspace and airports for Belarusian airlines, and also banned the aircraft of European companies from flying over Belarus. Also, in addition to the introduction of sanctions against representatives of the Belarusian authorities and companies associated with this incident, representatives of European institutions announce a significant tightening of sanctions that will be developed as part of the fourth and fifth packages of sanctions. According to some reports, sectoral restrictions against key state sectors of the Belarusian economy, in particular the export of potassium, oil products, and gas transit, are being discussed as sanction measures. The restrictions may also affect the possibility of sovereign borrowing by the Belarusian government in European markets, as well as attracting foreign loans by Belarusian banks. The intensification of sanctions pressure from the EU is developing against the background of the unfreezing of the US sanctions against 9 companies of the Belarusian petrochemical complex. At the same time, the US authorities declare their readiness to consolidate with the EU and further increase pressure on Lukashenka regime.

Against the background of growing tensions in relation with the West, the Belarusian authorities went to the escalation of the "trade war" with Ukraine, which joined the European ban for Belarusian airlines. So, the Belarusian government formally, in response to a 35% special duty on Belarusian trucks and buses, introduced licensing for the import of a wide range of Ukrainian goods (confectionery, chocolate, juices, beer, chipboard and fiberboard, wallpaper and others) for 6 months.

The current sanctions damage to the Belarusian economy is still moderate. Thus, the total reduction in the revenue of Belavia and Belaeronavigatsia, according to some estimates, will amount to about USD 90-100 million. In general, the aviation sector plays an insignificant role in the country's economy: for example, the share of passenger air traffic in the GDP is only about 0.2%. According to some media reports, the Naftan refinery is experiencing significant problems with the provision of raw materials: due to fears of secondary US sanctions, large Russian companies refrained from supplying oil to this enterprise. So, in May, pipeline oil supplies decreased almost 5 times. They supplies were not carried out in early June. At the same time, according to the assurances of Belarusian officials, the enterprise is working in full scale mode.

However, it is obvious that even if the declared threats to impose sectoral sanctions are partially realized, the losses of the Belarusian economy will increase many times over. Due to the low diversification of commodities in exports, the Belarusian economy is especially vulnerable to sectoral sanctions on the export of potash fertilizers and petrochemical products - only these two sectors provide up to a third of Belarus' exports. The greatest potential for damage is associated with a possible ban on the export of petroleum products to the EU - in 2020, this position provided about USD 1 billion, or more than 3.5% of merchandise exports. The export of Belarusian potash fertilizers to the EU is less significant - about USD 200 million, or about 10% of the export of this field. However, if the EU and the United States simultaneously impose sanctions on this sector, difficulties with the implementation of transactions may arise in the key markets for the

sale of potash: Brazil (USD 520 million in 2020), India (USD 321 million) and China (USD 290 million). While the ban on the transit of Russian gas through Belarus may result into a loss of about USD 350 million in transportation fees per year.

The experience of countries that have faced extensive sanctions pressure from the West (Venezuela, Iran, Cuba, Yugoslavia and others) shows that it is problematic to take the applied bans and restrictions without significant losses. In such a situation, the Belarusian authorities are taking steps to prevent the adoption of coordinated measures by the EU and the United States. Firstly, there are attempts to expand the circle of participants in the conflict by involving friendly countries in it. If the intention to support Belarus is officially declared on the part of Russia, then even within the framework of the EAEU no other states show such readiness. Thus, Kazakhstan has officially announced the inadmissibility of politicizing this organisation and using it in the sanctions struggle. Secondly, the Belarusian authorities have developed a set of countermeasures, including the introduction of an embargo on the import of goods from unfriendly countries, a ban on transit through the territory of Belarus and the creation of problems for foreign companies inside the country. Obviously, these measures are designed to play a frightening role in the logic of causing maximum damage to the enemy, however, their application in practice will create additional problems for the Belarusian economy, and, in fact, enhance the effect of the sanctions. Thus, the share of the EU countries, the USA and Ukraine, whose companies, according to Belarusian Prime Minister Raman Halouchanka, may face problems, account for up to 50% of foreign investments in the Belarusian economy.

In such conditions, the role of Russia as a key trading partner and a source of credit resources will increase dramatically. According to the results of May, we can say that the process of developing plans for further integration within the framework of the so-called “union state of Russia and Belarus” visually moved off the ground. Thus, the top nomenclature declares its political readiness to agree on a roadmap for the unification of tax legislation, which has been blocked by Belarus for a long time. According to Lukashenka’s statements, there is already an approach to resolve the issue of compensating Belarus for losses from the tax manoeuvre in the Russian oil sector, which recently seemed to be completely removed from the agenda.

The risks to economic growth

Against the background of growing risks, the official statistics continue to record the acceleration of economic growth in the country. At the end of 4 months, GDP growth exceeded the optimistic estimates of the authorities and amounted to 2.5%. At the same time, the growth in production is accompanied by a reduction in the relative stocks of finished goods, an improvement in the situation with external settlements, an increase in net profit and profitability of sales. Improvement in expectations is also recorded by independent business surveys - for example, the composite IPM index (analogous to the classic PMI index) has entered the growth zone over the entire history of observation. According to this survey, despite a very high assessment of current risks, the business is ready to expand its activities.

The main factor of economic growth is the improvement in the external environment. The comparative success of vaccination programs and the curtailment of the third wave of the COVID-19 pandemic is leading to an upward revision of the growth forecasts for the global economy. Thus, according to the June review of the World Bank,

the growth of the world economy this year increased from 4.1% to 5.6%. At the same time, the growth of the Eurozone economies should amount to 4.2%, Russia – to 3.2%, Ukraine – to 3.8%.

At the same time, the observed growth of Belarusian GDP remains highly concentrated. So, according to some data, up to 90% of the growth in industrial production, which is the driver of GDP growth, is provided by single large enterprises. Also, the current statistical result is largely related to the low base effect, since in April-May 2020 the Belarusian economy demonstrated the maximum level of subsidence for the year. In this regard, even according to optimistic forecasts (namely, in the absence of significant losses from sanctions) in the second half of the year, we should expect a decline in GDP growth. For example, in a recent survey, the World Bank maintains its forecast for the fall of the Belarusian economy in 2021 by 2.2%, which could make the country an absolute outsider in terms of economic dynamics in the Europe and Central Asia region. The likelihood of such a scenario increases with increasing sanctions pressure.

A significant reduction in investment in the economy is a problem for the authorities. The investments level in real terms decreased by 12.1%, and their share in the structure of GDP is 15.6% against the planned 21.3-21.4%. As a solution to this problem, government officials continue to announce a plan to launch the investment cycle. At the same time, there is considerable uncertainty regarding the sources of possible financing for this adventure. Thus, the banking sector is obviously experiencing problems with long-term lending, the investment attractiveness of Belarus in the light of recent events is greatly reduced, and the government is unable to significantly increase the national debt for this purpose.

The risks of financial instability

The favourable situation in the external sector is a key positive factor for financial stability. So, largely due to the net supply of foreign currency from legal entities (in the amount of USD 278 million in May) and a noticeable increase in the receipts of export duties to the budget, a noticeable increase in the country's gold and foreign currency reserves was recorded in May (by USD 485 million, or 6.7%). In general, the BYN demonstrates favourable dynamics, having noticeably strengthened over the month against the USD.

At the same time, it is obvious that it is too early to talk about a final change in the population's expectations. Due to the outflow of foreign currency deposits (minus 5.8% since the beginning of the year) against the background of stagnation of BYN deposits (an increase of 2.7%), total bank savings continue to decline. The population also retains the role of a net buyer of foreign exchange in the market - in May for the amount of USD 78 million. The persisting high inflation rate (8.6% in April yoy) forced the authorities to expand the practice of administrative price caps, although a month earlier the Prime Minister Halouchanka announced the possibility of complete cancellation of this measure. In such a situation, the National Bank continued to refrain from operations on the open market, and the provision of liquidity at the monthly auction again turned out to be minimal (in the amount of BYN 50 million with a total demand of BYN 924.5 million). Despite the local improvement in budget execution (in January-April, its surplus amounted to more than BYN 400 million compared to the deficit of BYN 1.86 billion a

month earlier), the Ministry of Finance revised the plan for the budget deficit towards growth above BYN 6 billion, or about 3.5% of GDP.

The growth of gold and foreign currency reserves observed for the second month in a row, as well as the receipt of a tranche of a Russian loan in an amount equivalent to USD 500 million, relieve tension with servicing the public debt in the short term. At the same time, the task of the authorities becomes more complicated in the medium term. The escalating conflict with Western countries significantly increases the cost of potential borrowing, and in case of appropriate decisions, Western debt markets for Belarus may be completely blocked. At the same time, in 2021 and 2022, the main payments on the state debt fall on Russia and China, and, accordingly, the issue of servicing it is largely a matter of bilateral relations with these countries. Significant payments on bonds are expected only in 2023 in the amount of USD 800 million.

Conclusions

The introduction of sectoral sanctions by the EU, the US and Ukraine against key export industries could become a serious “black swan” for the Belarusian economy. At the same time, the possible scale of the sanctions and the ability of the authorities to minimize losses from them remain unclear. The economy is supported by a favourable situation in the external sector and a gradual growth of entrepreneurial optimism, which was observed before the aggravation of relations with the West.

