

Analytical report:
Economic security of Belarus
(June 2021)

The risks to economic independence

Key risks for the economy are still associated with a sharp deterioration in relations with Western countries. The main event of the month was the introduction of new sanctions by the EU. So, at the end of June, the long-announced 4th package of sanctions was signed, including restrictions on 78 people (mainly officials, representatives of the law enforcement agencies and several businessmen close to the government) and 8 organizations (including such industrial giants as Minsk Automobile Factory (MAZ), Belarusian Automobile Factory (BelAZ), as well as companies from the field of logistics and trade in petroleum products).

Almost simultaneously with the 4th package, the EU also announced the first sectoral sanctions against the Belarusian economy - previously, the EU did not use this instrument at all. The ban on the sale and transit of products included Belarusian companies in production of oil products, potash fertilizers as well as the tobacco industry. Restrictions also affected the financial sector – there is a ban on insurance and reinsurance of Belarusian state-owned companies as well as a ban on long-term (for more than 90 days) lending to state banks, while the access to the EU capital market for the Government of Belarus is closed. At the same time, sectoral sanctions include some exceptions and caveats that make them not as destructive as it seemed at the preparatory stage. Thus, the main type of potash fertilizers, which accounts for more than 80% of total potash exports, was excluded from the sanctions list. In addition, the sanctions do not apply to contracts already concluded. Accordingly, the impact of the current restrictions on the Belarusian economy will be extended over time and is unlikely to be shocking.

The amount of losses as a result of the sanctions does not look catastrophic at the moment, but it is expected to be significant. Thus, the assessment of export losses varies in the range of 2-3.5% of its annual amount, with a maximum estimate of up to 9% with an expanded interpretation of the sanctions conditions and taking into account transit through the EU. The possible total loss of GDP caused by the effect of the sanctions restrictions, which may mainly occur in 2022, is estimated from 3 to 6%.

At the same time, the EU pressure on Belarus does not look complete, and it is worth considering the risks of increased sanctions. So, the European authorities have already begun to announce the 5th package of sanctions (although, according to media reports, it will be adopted no earlier than autumn). If the conflict escalates, changes may be made to the current sanctions regime as well. The impact of the sanctions can multiply when the United States and Ukraine join them. According to some reports, the US authorities may take this step as early as August. The likelihood of Ukraine joining the sanctions is much lower - Belarus remains an important trading partner for this country, especially in terms of the supply of oil products. The fact that despite the tough political rhetoric, the Ukrainian authorities are counting on the preservation of economic ties with Belarus may be evidenced by the suspension of special duties on Belarusian buses, trucks and special equipment on the Ukrainian market. Earlier, introduction of these duties by Kyiv was the reason for the imposition by the Belarusian authorities of restrictions on the import of a wide range of mainly consumer goods from Ukraine.

Despite the emotional public outrage, the reaction of the Belarusian authorities to the sanctions is restrained. At the moment, the authorities have made only a symbolic step to suspend participation in the Eastern Partnership. Promises to restrict the transit of

goods through Belarus to Russia and China, as well as create problems for foreign business operating in Belarus (source), are still only threats.

In such conditions, the dependence of the Belarusian economy on Russia continues to grow. In addition to the roles of a key trading partner and lender, with the closure of Western markets for Belarusian products, Russia can play an important role in minimizing and circumventing sanctions restrictions. So, despite the refusal of large Russian companies due to fears of secondary sanctions from the United States to supply oil to “Naftan”, the refinery is not experiencing significant problems with raw materials. Experts explain this situation by the fact that the demand of the Belarusian refinery is most likely covered by supplies from small Russian companies. This situation is very different from the beginning of 2020, when Belarus refused to buy oil from large suppliers and the Russian authorities blocked such supplies at the political level. In general, the Russian authorities declare their readiness to provide comprehensive support to Lukashenka regime in case of such a need.

In turn, the Belarusian authorities declare optimism about further integration within the framework of the so-called “union state”. So, according to the statement of the Prime Minister Raman Halouchanka, all roadmaps for integration have actually been agreed upon, and now only their technical revision is being carried out. The Ambassador of Belarus to Russia Uladzimir Siamashka expects that the integration roadmaps will be signed in September-October, and from January 1, 2022, the single oil, gas and transport markets will start operating. At the same time, any detailed information about the specific composition and content of these maps has not been made public.

The risks of financial instability

The sanctions adopted by the EU increase the risks in the financial system and exacerbate the existing problems in the banking system. Thus, the growth of negative expectations against the background of sanctions intensifies the problem of violation of the savings process, which has been relevant for the entire last year. With a high probability, we should expect another acceleration of the outflow of deposits, which does not stop anyway, despite the expectations of the authorities. Thus, the size of foreign currency deposits of the population has decreased since the beginning of the year by almost 9%, after some growth for the second month in a row, BYN deposits are also decreasing. Record levels are shown by both the observed inflation (in June it reached 9.9% in annual terms) and the inflation expected by the population (according to the National Bank’s research in June it was 14.7%). This situation contributes to the preservation of net demand for foreign exchange on the part of the population in the foreign exchange market. The outflow of non-resident funds from banks will aggravate problem with foreign exchange liquidity. This is due to the direct effect of the sanctions bans and due to the growth of negative expectations.

Obviously, given these risks, the National Bank decided to abolish the restrictions on the size of rates on foreign currency deposits. The rate cap was introduced in 2019, and was explained by the need to de-dollarize the economy. Apparently, against the background of potential problems with currency in the banking system, the National Bank is ready to temporarily abandon the fight against the high level of dollarization of the economy. Previously the National Bank estimated the annual losses due to it at 2-3% of GDP.

The sanctions also create problems for the authorities with the servicing of the public debt. If this year the authorities provided sources of financing for these needs, then next year they may face significant difficulties. In the conditions of blocking Western markets, the government is counting on borrowing in the Russian, Asian and domestic markets. However, the potential of each of these areas raises questions. Thus, the government expects to attract RUB 100 billion in the Russian market over the next 3 years. At the same time, even under the conditions of Western sanctions, the cost of such placements may turn out to be acceptable - for example, the current quotations of Belarusian bonds in RUB did not collapse after the imposition of sanctions and their yield is about 8.5% per annum. However, the capacity of such borrowings is doubtful - earlier the Belarusian authorities were able to simultaneously place bonds on the Russian market for no more than RUR 10 billion (about USD 150 million). Belarus has no experience of sovereign borrowing in the Asian market at all. Earlier, the government was considering entering the Chinese panda bond market, but refused from it. According to some reports, this was due to the too low credit rating of Belarus and the high cost of borrowing. The internal market is an important source of foreign exchange resources for the authorities this year. So, in January-May, the net placement of government bonds on it exceeded USD 700 million. However, it is unlikely that such dynamics will continue in the future - large-scale borrowings by the authorities limit potential resources for the private sector and restrain economic growth. In addition, in the event of an increase in the outflow of foreign currency deposits, banks, which are traditionally the main buyers of government debt, will not have free resources to purchase government bonds in the same volumes.

At the same time, a situation of financial stress in the near future still is unlikely. The situation in foreign trade is favourable - the growth of merchandise exports outstrips the growth of imports (+ 38.9% against + 28.9%), and taking into account the services, the foreign trade balance remains positive (almost USD 1.25 billion in January-May). According to experts' expectations, this situation, which is even called a "foreign trade miracle", will be levelled out in the second half of the year, but the exhaustion of this factor will take some time. Despite the reduction in June (by USD 354 million to USD 7.4 billion), the level of the country's gold and foreign exchange reserves is still significant. It is indicative that during the next revision, after the imposition of sanctions, the S&P rating agency still retained the country's credit rating at "B" with a negative outlook. Despite the sanctions, the agency does not expect drastic failures for the balance of payments of Belarus. They also proceed from the assumption that if the financial situation deteriorates, the authorities will be able to receive the necessary assistance from Russia.

The risks to economic growth

Against the background of a low base last year and favourable external conditions, the Belarusian economy continues to demonstrate acceleration - by the end of May, GDP growth amounted to 3.1%. At the same time, the components of this growth remain the same - due to the activation of external demand, industry shows good dynamics (an increase of 11.1% in 5 months). This is connected with the success of several export-oriented industries: woodworking (an increase of 24.5% in May), manufacturing of machinery and equipment (an increase of 26.6%), vehicles production (an increase of 26.3%). At the same time, domestic consumer and investment demand continues to

stagnate. Thus, retail turnover for 5 months fell by 0.7%, while investments in May decreased by 10.4% year-on-year base.

Exhaustion of the “foreign trade miracle” will slow down the dynamics of the economy, and sanctions will also have a significant impact on the size of GDP. Moreover, there are several mechanisms of such influence. Thus, a break in production chains (for example, a ban on the supply of European components) will weaken the competitiveness of Belarusian manufacturers (BelAZ is already facing such a problem). The problem of redirecting the flows of the products banned for import into the EU without loss is hardly solvable. Economic growth will also be restrained by the rise in the cost and decrease in the availability of credit in the economy, caused by the growth of negative expectations and the outflow of deposits from banks. Against the backdrop of negative expectations, further contraction of domestic investment and consumer demand is likely, especially in terms of housing construction and consumption of durable goods. As a result, against the background of the rapid recovery of the world economy, even according to the forecasts of the friendly EDB, GDP growth in Belarus by the end of the year will slow down to 1.3% (the lowest level among all EAEU countries), and in 2022 it will even reach 0%. In the event of new external shocks (for example, another wave of the COVID-19 pandemic caused by a new delta strain, or the collapse of the OPEC + deal), the dynamics of the economy will worsen.

Conclusions

The sectoral and other sanctions introduced by the EU, despite their limitations and the actual postponement of the start of action, pose risks to the financial stability and economic growth of Belarus, especially taking into account their possible tightening and the United States joining them. The country’s economy is supported by a favourable external environment, the factor of which, however, will gradually be exhausted. In such a situation, the readiness of Russia to support Belarus and, accordingly, the readiness of the Belarusian authorities to make compromises, for example, in matters of deepening integration, is of increasing importance.

