

Analytical report:
Economic security of Belarus
(January-March 2022)

Minsk

The risks to economic growth

The first quarter of 2022 was a turning point in terms of the development of the Belarusian economy in the short and long term. Large-scale foreign trade, logistical and financial sanctions and restrictions, as well as the loss of Ukraine as one of the key trading partners, are fundamentally changing the future of the country. If at the beginning of the year the dynamics of the Belarusian economy looked moderately positive, then by the results of the first quarter of 2022, it rapidly entered the recession zone. The fall in the country's GDP in March compared to March last year amounted to about 3.3%, and the final figure for the first quarter was minus 0.4%. At the same time, the fall in the economy will inevitably deepen, and in April, according to some estimates, it may reach 10% compared to April last year. A significant recession is predicted by various international funds based on the results of the entire year (Table 1). At the same time, the high uncertainty about further sanctions makes such estimates very preliminary. The duration of the recession is also not clear, since it is highly likely to be not cyclical, but structural, transformational in nature.

Year \ Evaluation of GDP dynamics	IMF	World Bank	EBRD	S&P
2022	- 6,4	- 6,5	- 3	- 15
2023	0,4	1,5	0	- 5

Table 1. Forecasts of GDP dynamics in Belarus in 2022-2023, %

Such significant losses to the economy are due to the unprecedented nature of the sanctions measures taken: they affect key export industries and producers of the country and seriously limit the transit potential of Belarus. Thus, a direct export ban has been introduced for the country's oil refineries, chemical industry enterprises, the export of woodworking products has been seriously restricted, access to the Baltic ports for the transportation of potash fertilizers has been closed, and the work of Belarusian cargo carriers in the EU has been significantly limited. As a result, the refineries of the country, which in recent years provided 12-20% of Belarus' export earnings, are forced to completely switch to working only on the domestic market and reduce the volume of refining by more than 2 times. It is obvious that Belaruskali, which is quite unexpectedly completely closed in April for a major overhaul, is also experiencing problems with supplies to export markets. Due to the loss of access to the Baltic ports, annual contracts with consumers in India and China were not signed, which usually happened in the first months of the year. At the same time, it is apparently not possible to ensure similar volumes of sales to China by railroad deliveries. Since March, shipments of potash fertilizers to Brazil have also been suspended, the export of which there in 2021 exceeded USD 580 million. In general, according to BEROC experts, sanctions and the loss of the Ukrainian market affect up to 30% of Belarusian exports. At the same time, already in

March, according to the statement of the Minister of Economy, the reduction in exports compared to the same month last year amounted to about a third of sales.

Comparable losses may also be associated with voluntary steps by international companies to withdraw from or self-restrict operations in the Russian and Belarusian markets. Thus, the possibility of customers refusing the services of Belarusian companies for reputational reasons caused a massive wave of relocation in the IT industry. There is no exact data on this process, but industry surveys show that relocation has already affected up to a third of industry employees, and the process will continue further. A landmark event in the industry was the announcement of the complete withdrawal of Wargaming – one of the largest employers in the sector (more than 2 thousand employees at the beginning of the year) and the country's main product company – from Belarus.

At the same time, in addition to the shock on the demand side, which is already actively expressed in the reduction of exports of goods and services, sanctions and restrictive measures create a shock on the supply side. Quite quickly, it will manifest itself through a break in technological chains and a reduction in intermediate imports. According to the estimates of the Russian authorities, starting from the second half of the year, the depletion of stocks of imported components and raw materials can become a significant problem for maintaining the continuity of the technological process at the macro level.

The sanctions will also have a significant negative impact on investment activity in the country. The contraction of the domestic market, retaliatory counter-sanctions (in particular, restrictions on the withdrawal of capital) and reputational costs will greatly reduce the country's attractiveness for Western investment. The interest of Chinese investors will, in turn, be cooled by the loss of the country's logistical attractiveness and the risks of being included in the sanctions lists. We should also expect a contraction in private domestic investment, due to the problem with the resource base for such investments and the deterioration of business economic expectations. Thus, the index of business optimism, according to the estimates of the Republican Confederation of Entrepreneurship, fell to the minimum level for all 17 years of its calculation. In such a situation, the investment activity of the state may be forced to increase. At the same time, the effectiveness of this practice may not be high, since in previous years the Government has not been able to solve the problem of increasing the efficiency of its investment apparatus.

In the long term, sanctions will significantly reduce the country's economic growth potential. The restructuring of economic chains will be accompanied by a switch to alternative less technological, lower quality and more expensive imports and forced import substitution. At the same time, the output of some high-tech products may be completely lost. The long-term potential for economic growth will also be strongly affected by the loss of human capital caused by both the outflow of the able-bodied population and the gradual degradation of the social sphere (primarily medicine and education). In the case of Belarus, an active process of outflow of the population is manifested through a “brain drain”, primarily in the IT sector, a high-performance industry that has been the main driver of economic growth in recent years.

The key factor, which should partially offset the sanctions losses for the country's economy, may be the growth of exports to Russia against the backdrop of reduced competition and the opening of free niches there. For example, a significant increase in demand for Belarusian products in the household appliances market is already being recorded. The ability of Belarusian producers to take advantage of this situation depends on the ability to replace the missing intermediate imports with supplies from alternative producers (for example, Chinese).

At the same time, it is still difficult to call the anti-crisis program of the authorities corresponding in scale to the problems that the economy is facing. Following the example of 2020, it is mainly focused on targeted assistance to producers and exporters. Steps to support the population have so far only been announced without any details. The possible liberalization of the economy discussed in the press is not being implemented in practice either. It is the emancipation of the entrepreneurial initiative that official Russian experts consider as a key factor in accelerating adaptation and structural transformation of the economy. The Belarusian authorities have so far limited themselves to only lifting the travel ban for citizens and raising the limit on the cost of parcels from abroad. At the same time, there is no information that the authorities may abandon their plans for a large-scale reformatting (and actually raising) taxes for small businesses in 2023. The decision to raise the fee for companies participating in the HTP from 1% to 2% of revenue also looks doubtful.

In general, the forced transformation of the economy may pose a politically sensitive issue for the authorities to close some traditional enterprises. In particular, the loss of the European and Ukrainian markets raises the question of the expediency of the existence of two large refineries in the country, which are clearly excessive for the domestic market. Attempts by the authorities to preserve the structure of the economy at any cost, incl. through the budgetary redistribution of resources from more successful sectors of the economy to problematic ones, can only exacerbate the economic problems in the country.

The risks of financial instability

Sanctions, both directly and through secondary effects, create significant risks for the financial sector as well. Direct threats to financial stability are associated with the ban in the EU on transactions with the National Bank of Belarus and the financing of trade and investment, the disconnection of certain banks from the SWIFT system (including the second largest bank in the country, Belagroprombank), and a ban on the supply of euro cash to Belarus. The secondary effect of sanctions is associated with a sharp drop in confidence in the banking system, which is reflected in a significant outflow of deposits and an increase in demand for cash.

At the same time, it should be noted that the country's financial system survived the period of primary acute shock quite successfully. In late February-early March, the National Bank repeated the tactics of the post-election 2020: amid a sharp increase in demand in the foreign exchange market, the regulator refused to provide BYN liquidity to banks, took administrative steps to limit consumer lending, and also refrained from trying to keep BYN exchange rate with foreign exchange interventions. Also, the National Bank did not go for the introduction of currency restrictions, following the example of the Russian Central Bank, which, in the conditions of a high level of dollarization of savings, could increase panic. In particular, the regulator did not resort to

such measures as the mandatory sale of foreign currency by exporters, the introduction of limits on the withdrawal of foreign currency from accounts and its withdrawal from the country, restrictions on the purchase of non-cash currency by companies and cash currency by the population. At the same time, the National Bank did not prevent the introduction of similar measures by some commercial banks for their clients. As a result, the exchange rate of BYN against USD, after jumping to almost BYN 4 per USD on the free market in early March, fell to below BYN 2.7 per USD in mid-April. According to statistics for March, even despite the panic demand at the beginning of the month, the population remained a net seller of foreign currency (in the amount of USD 220 million). At the same time, an important factor in the recovery of the Belarusian currency against the dollar was the strengthening of the Russian ruble, which is observed against the backdrop of a strong foreign trade balance. This became possible due to the fact that despite the steps taken by Western countries to reduce purchases of Russian energy resources, Russian exports have not yet contracted as significantly as imports. As a result, the foreign trade surplus even reaches record levels (for example, in the first quarter it amounted to USD 66 billion compared to USD 25.8 billion in the same period last year).

The costs of this policy of the National Bank were a sharp reduction in gold reserves at the end of the month - in March their size fell by USD 700 million, and the total reduction over the past two months has already exceeded USD 1 billion. Lack of BYN liquidity among banks led to a significant increase in rates in the deposit and credit markets, as well as the curtailment of many credit programs, incl. for residential real estate lending.

Despite overcoming the primary shock, medium-term sanctions risks remain significant. Judging by the dynamics of rates, the problem of reducing the deposits of the population, and especially their currency component, remains topical. In March, the outflow of funds from foreign currency accounts and deposits of citizens exceeded USD 620 million, or more than 12%. This trend is likely to weaken in April, but for its cardinal reversal, it is necessary to restore confidence in the banking system. Strengthens the problem with the formation of the resource base of banks and the loss of access for them to the international capital market.

The contraction of the economy also significantly increases the credit risk for banks associated with a sharp increase in the level of bad debts. At the same time, unlike the statistics of the foreign exchange market, indicators of bad debts are more prone to concealment and, according to estimates that were previously expressed by international funds, their official level (only 5.3% of bank assets) does not reflect the full severity of the problem.

Increased inflation also has a destabilizing effect on the financial market. In March alone, consumer prices grew by 6.1%, and year-on-year inflation accelerated to 15.9%. Further movement of consumer prices has a high degree of uncertainty. On the one hand, the recovery of BYN and the sharp cooling of the economy will have a pronounced deflationary impact. Thus, according to weekly statistics in Russia in early April, there is a sharp slowdown in inflationary processes. On the other hand, further tightening of sanctions, in particular restrictions on the import of Russian energy resources (up to the imposition of an embargo on Russian oil imports), may provoke a new round of weakening of the Russian ruble and intensify the inflationary spiral.

Forced measures of the authorities to support the economy may also have an inflationary impact. In the context of a sharp contraction in external and domestic demand, as well as rising unemployment, the authorities can go for an easing of budget rules and expanding support for producers (providing state guarantees, subsidizing interest rates, and budget financing). Such actions of the authorities may have justification from the point of view of the real sector, but they will become an additional impetus for inflation.

The risks of servicing the state debt have also grown significantly, which is also reflected in the new sovereign ratings of Belarus: in March, international agencies drastically downgraded the country's credit ratings to the pre-default level. In addition to the inability to refinance debts through borrowing on the international market and the limited foreign exchange reserves, the authorities also face technical problems with foreign exchange payments. The next significant payment for the repayment of Eurobonds in the amount of USD 800 million is due in early 2023. At the same time, a possible default on foreign obligations for Belarus will have more painful consequences than for Russia, due to the high level of dollarization of the Belarusian economy.

The risks to economic independence

An important result of the sanctions pressure is a sharp increase in the dependence of the Belarusian economy on the Russian one. The role of Russia, which is already the main economic partner, is growing sharply in all aspects of cooperation: foreign trade, investment, and logistics. The Belarusian authorities hope to partially compensate for the loss of exports that previously fell to the Ukrainian market (about USD 5.5 billion) by reorienting commodity flows primarily to the Russian and Chinese markets (in the amount of USD 1.9 billion and USD 1.7 billion, respectively). Also, Russian manufacturers are considered as a priority to replace the falling production chains. For example, a large manufacturer BELAZ announces the start of mass production of dump trucks with Russian engines. Obviously, in such a situation, Russia's share in the country's foreign trade will increase significantly from more than 50% in the first months of 2022.

At the same time, Russia is becoming the main transit route for Belarusian products to the markets of third countries. The government considers the accelerated construction of its own terminal in the port of St. Petersburg as a key condition for the restoration of potash exports. The authorities also hope to expand the use of the railway communication through Russia for trade with China.

Also, Russia remained practically the only source of financing for the Belarusian state debt. Thus, the authorities of the countries agreed on restructuring (in particular, postponing payment) this year the debt to Russia in the amount of USD 1 billion. New agreements between the countries in the energy sector are also called upon to provide support for the Belarusian economy. So, since April, governments have fixed gas prices in Russian rubles until the end of 2022. Such a move should reduce the pressure on the country's foreign exchange reserves, as well as, in the future, somewhat reduce the real cost of gas for the economy.

Conclusions

In the first quarter of 2022, the Belarusian economy faced challenges that could become the most significant in its entire sovereign history. Large-scale sanctions, the loss

of the Ukrainian market and the limitation of the level of international cooperation lead not only to a significant reduction in the country's exports, but also provoke a structural crisis in the economy. The possible depth of the economic downturn and the time it will take for the economy to adapt to new operating conditions are uncertain and depend on its adaptive capacity. The long-term consequences for the economy risk falling productivity, structural simplification and loss of human capital.

