

**Analytical report:**  
**Economic security of Belarus**  
**(April-June 2022)**

## The risks to economic growth

The dominant factors that determined the significant dynamics of the Belarusian economy in the second quarter were the sanctions and the loss of the Ukrainian market. At the same time, the authorities reacted to the numerous negative information by reducing officially published statistics. In particular, statistics on the commodity structure of foreign trade, public debt indicators, reports on budget execution, and so on, have stopped to be published. This makes information about the economic situation fragmentary and narrows the possibilities for its analysis.

As long as the statistics on the country's GDP remain in the public domain, one can say that the economy is plunging into a deep recession. So, according to the results of the first half of the year, the fall in the country's GDP amounted to 4.2%, while the reduction is demonstrated by all regions and almost all major industries, except for the IT sector. The manufacturing industry decreased by 6%, agriculture - by 3%, construction - by 12.5%, freight turnover - by 21.9%. Further deterioration in GDP indicators is beyond doubt - the IMF, the Eurasian Development Bank and the World Bank predict a fall in the economy by 6.4–6.5% by the end of 2022. At the same time, monthly statistics signal that the economy has reached a short-term bottom, or at least approaching it. Thus, the fall of the economy in June against the level of last year amounted to 7.8% - 8%, which is somewhat less than it was in May - 8.6%.

The greatest consequences in the short term are created by risks associated with a sharp deterioration in the situation in the external sector due to the introduced trade restrictions and bans, as well as the loss of the Ukrainian market. At the same time, the sectoral coverage of such bans continues to increase: for example, since June, the European market has been closed for Belarusian timber, ferrous metals and products from them, cement, and tires. The authorities estimate potential losses in foreign trade for a year up to a third of Belarusian exports. At the same time, the logistical possibilities to redirect falling exports to alternative markets are limited.

However, despite the reduction in exports, the country's foreign trade balance remains positive and even formally improves relative to last year. According to the National Bank, the foreign trade surplus for 5 months of 2022 amounted to more than USD 1.7 billion compared to USD 1.3 billion a year earlier. This situation is due to both the accelerated reduction in imports and the favourable price environment for goods exported by Belarus. As a result, the physical decline in exports overtakes its cost change.

In this regard, very significant risks for export prices are associated with the threat of a slowdown in the global economy. Against the backdrop of record inflation in recent decades, world central banks began to tighten monetary policy. The most significant attention here is focused on the actions of the US Federal Reserve - since the beginning of the year, it has also raised the discount rate from 0-0.25% to 1.5-1.75%, and its further growth seems inevitable. In such a situation, the risks of a recession in the American economy have sharply increased - for example, according to the results of the first quarter, its decline was 1.5%. China's economy is also showing unusually weak growth - in the second quarter, its GDP grew by only 0.4% compared to last year. As a result, commodity prices have been falling in recent months. Thus, copper prices fell by 30% from peak levels, wheat - by almost 40%, oil - by 23%. The continuation of such trends will neutralise the positive impact of export prices for Belarusian goods, and worsen the results of trade for the country.

If the shock from the side of demand manifests itself reactively in the country's economy, then the effect of the supply shock is not so noticeable yet. It is difficult to say whether this is due to the presence of stocks from manufacturers, the use of loopholes in imports, or finding alternative suppliers from "friendly" countries. In any case, there are no facts in the media about stopping production due to a lack of components or mass transfer of employees to part-time employment for this reason. Rather, on the contrary, manufacturers are trying to reduce production not as significantly as sales have fallen, which ultimately leads to an increase in stocks of finished products. Over the year, their size increased by 45% and reached 71.7% of the average monthly production compared to 56.8% a year earlier.

The risks associated with the foreign business' and companies' operating in the Western market leaving Belarus are more noticeable. Thus, negative trends are observed in the IT sector, which has been one of the stable drivers of the economy in recent years. Since spring, this industry has recorded a significant reduction in employment – according to official statistics for March-May, the number of employees in it decreased by 5.5 thousand people. Unofficial calculations report an outflow rate of about 20 thousand employees since the fall of 2020. In the context of the predominantly outsourcing model of Belarusian IT companies, this situation led to a sharp slowdown in the growth of the industry. In June, its growth decreased to 1-1.2% against the level of the previous year (month on month), and the final positive contribution to the overall economic dynamics amounted to only 0.1 percentage points.

The secondary effects of trade sanctions are manifested in the reduction of investment and consumer activity in the country. The reduction is also shown by the real incomes of the population (by 2.1% in January-May), and even retail trade turnover (by 0.4% over half a year). The topic of launching a new investment cycle, which was actively promoted throughout the previous year, has completely disappeared from the current agenda of the government. As a result, Belarus continues to experience a reduction in investment, which began in 2020. The investment decline for six months amounted to 17.1%, while in June it exceeded 27% on a monthly basis. The fall in investment activity, in addition to the short-term negative effect on GDP, also reduces the potential for economic growth in the medium term. Thus, the EDB already estimates the potential for economic growth in Belarus in the medium term below 1% per year. On the other hand, earlier in the economic history of Belarus there were precedents when large-scale state investments played a destabilising role for the financial market. The current situation offsets this risk.

The pressure of sanctions and the resulting economic downturn also reinforce the country's strategic problem associated with the reduction of the working-age population. Thus, according to statistics for April, the number of people employed in the economy over the past year decreased by 53.3 thousand people. The economic depression will increase migration flows from the country. The country's human capital will also be negatively affected by the gradual degradation of the social sphere, associated, for example, with the outflow of qualified personnel and the forced cuts of the state budget for social purposes.

The key factor contributing to the stability of the Belarusian economy is the growth in demand in the Russian market. Against the background of a significant trade surplus in Russia and a decrease in the level of competition, Belarusian manufacturers can really

count on an increase in sales in the Russian market – the authorities plan to increase exports to Russia by 40%, or USD 6.5 billion, by the end of the year. First of all, this concerns the products of manufacturers of machinery, equipment, and food products. At the same time, a significant increase in the export of potash, nitrogen and mixed fertilisers, oil products and wood products to Russia or in transit through Russian ports and railways in the short term looks impossible due to existing logistical problems (the authorities estimate the scale of such losses at USD 12 billion).

In an extremely difficult external environment, the policy of the authorities to support the national economy is in many ways reminiscent of their behaviour during the coronavirus recession. A set of emergency measures developed by the Government and involving a temporary easing of the tax and regulatory burden on business and the population, as well as the liberalisation of certain aspects of economic life, has not yet been agreed at the highest level. The government did not resort to direct financial support of the population and business either. Moreover, there are plans to raise taxes for small businesses in 2023.

The government stepped up support for exporters and the implementation of the import substitution program. In particular, BYN 4.5 billion is provided for compensation of preferential interest rates for export credit, which is 40% more than in 2021. The regulation of some issues related to export credit has been simplified. The government also has targeted steps to change the regulation of certain issues: simplification of cross-border trade (visa-free entry for citizens of neighbouring EU countries, the ability to deposit cash into an organisation's account), simplification of the rules for individual construction, a return to the old level (from 2% to 1%) fee for HTP members.

The authorities' refraining from drastic retaliatory counter-sanction measures can also be considered a plus. These include the government's decision to ban foreign investors (219 companies on the list in total) from alienating shares in their Belarusian organisations. Such a decision, of course, will have a negative impact on the desire of these investors to expand their business in Belarus, however, in the current situation, this was unlikely anyway. At the same time, the Belarusian government did not show integrity, and against the backdrop of growing inflation, reduced the list of goods prohibited from importing from the EU.

### **The risks of financial instability**

At the same time, the situation in the financial sector is gradually improving - the risks that destabilised the markets at the beginning of spring have mostly been stopped. The BYN exchange rate against the USD has recovered to the pre-crisis level, and the National Bank is even forced to fight against its excessive BYN strengthening. The foreign exchange market remains steadily in surplus – only in June, for the first time in 12 months, the purchase of foreign currency by the population slightly exceeded its sale. The country's gold and foreign exchange reserves remain within the forecast framework: after a sharp fall in February, their further dynamics was insignificant – from April to June, the size of the gold reserves decreased by USD 65 million to the level of USD 7.5 billion. The size of both currency and BYN deposits of the population began to gradually increase. The situation with bank liquidity has also changed dramatically – after its severe deficit in March, by summer the situation was replaced by a significant surplus, and rates on the interbank market fell from 32% to 2%. Under such conditions, banks are

gradually stepping up lending activities, expanding the number of programs and reducing rates.

At the same time, medium-term and long-term risks in the financial sector continue to grow. Inflation remains significant – in July its level was 17.6%. A strong pro-inflationary factor is the significant BYN weakening against the RUB – since the beginning of the year it has exceeded 30%. This neutralises the economic slowdown factor and greatly differs the situation in Belarus from Russia, where deflationary tendencies have been observed in recent weeks.

The National Bank is still unable to balance the banking liquidity market and restore its manageability. The dynamics of the market has a pronounced swing character, when a period of strong deficit is replaced by a situation of significant surplus, and the National Bank is forced to refrain from using standard management mechanisms. If at the beginning of spring the National Bank refused to provide liquidity to banks, then since July it has refused to attract banks' funds through the mechanism of deposit auctions. Such a move reduces the opportunities for banks to allocate free resources, and stimulates them to expand lending operations.

The situation with the execution of the budget is also deteriorating significantly. According to the latest published statistics (after which the Ministry of Finance stopped posting these data on its website), the consolidated budget deficit for 5 months amounted to BYN 211 million, or 0.3% of GDP. This is the worst result for this period of the year since the 90s.

But the most potentially problematic situation is with servicing the public debt. At the end of June, the government and the National Bank adopted a joint resolution on the payment of interest on Eurobonds in BYN to an account in Belarusbank. The authorities justified this decision by saying that the Western settlement and clearing system did not ensure the final transfer of funds transferred by the government of Belarus to the accounts of securities holders. At the end of June, according to this scheme, another payment of coupon income was made to holders of Belarusian bonds. In response to this step, the rating agencies Fitch and Moody's downgraded Belarus' credit rating on foreign currency obligations to the level of selective default. S&P reacted more restrained and refrained from downgrading, indicating that the Lukashenka regime is looking for alternative payment methods in US dollars. Recognition of the sovereign default of Belarus will have long-term consequences for the economy – it will close the international capital markets for a long period both for the state and for the private sector. Risks for state property abroad associated with potential lawsuits by bondholders cannot be ruled out. At the same time, the default will have a limited effect on the current domestic foreign exchange market and will not be comparable to the consequences of the 1998 default in Russia.

### **The risks to economic independence**

Building and deepening economic ties with Russia is a natural response of the Belarusian economy to the challenges caused by sanctions. The share of Russia in the structure of foreign trade continues to increase – in January-May it accounted for more than 50% of Belarusian imports and 63% of exports. At the same time, in May, a record export to Russia was recorded in the entire history of observations – in the amount of USD 1.65 billion, which is almost 30% more than last year. It is noteworthy that the

hopes for country diversification of exports are largely associated with the use of Russian logistics. Thus, the Belarusian authorities plan to take over and expand the port terminal in the Leningrad region. This should contribute to the restoration of Belarus' positions in the potash fertiliser market.

The dependence of Belarus on Russia as a source of credit resources is also growing. The recognition of default will not only close Western capital markets for Belarus, but will also complicate attraction in Asian markets. In such a situation, Russia and its affiliated structures become the monopoly creditor of Belarus.

The expansion of non-market targeted lending by the Russian authorities to projects in Belarus is also noteworthy. Thus, certain hopes of the Lukashenka regime for the restoration of economic activity are also associated with participation in import-substituting projects financed by Russian structures. According to the current agreements, Belarusian enterprises should use about USD 2.5 billion within 10 projects. The Russian authorities plan and finance the re-equipment of Belarusian schools in the amount of about USD 180 million.

### **Conclusions**

The economy of Belarus is experiencing a massive decline caused by sanctions and the loss of the Ukrainian market. At the same time, the rate of decline began to slow down, which may be evidence of the gradual adaptation of the economy to existing conditions. A characteristic feature of the current crisis is a strong foreign trade balance, which is explained by the accelerated reduction in imports, favourable pricing conditions and increased sales to Russia. The threat to exports in this context is the observed fall in commodity prices. The question of a possible supply-side shock (restriction in the availability of raw materials, components and technologies) remains open, which has not yet been actively manifested.