

**Analytical report:**  
**Economic security of Belarus**  
**(July-September 2022)**

**Minsk**

## The risks to economic growth

Current statistics suggest that the short-term shock to the Belarusian economy associated with a sharp deterioration in foreign trade conditions has already been exhausted. Thus, for the second month in a row, the GDP dynamics has been improving. If over the period January-July the economy declined by 5.2%, then over January-August – by 4.9%, over January-September – by 4.7%. In monthly terms, the dynamics is even more pronounced: if in July the fall in GDP was more than 10%, then in August and September it was about 3%. The basis for such a significant improvement was the results of agriculture associated with a good harvest of grains and vegetables. However, even without taking into account the indicators of agriculture, statistics record a gradual recovery of the economy. The main driver of the observed industrial recovery has been foreign trade, which is improving markedly after a deep fall in early spring. So, if in the first quarter of 2022 the volume of exports was only 75.6% of the value for January-March 2021, then according to the results of 8 months, it increased to 96.8%. In August, merchandise exports even slightly exceeded the level of 2021, while the reduction in imports was about 11%. It should be noted that these figures were achieved despite the ongoing problems with the export of potash fertilisers and oil products. Thus, according to the Canadian company Nutrien, the export of Belarusian potash to the world market in the first half of the year in physical volume amounted to only 50% of the level of the previous year. In turn, the recovery of exports became possible due to an increase of about 30-40% in dollar prices for products exported by Belarus, including due to the strengthening of the Russian ruble against the USD.

From the point of view of the regional structure, the recovery of exports is due to its growth to Russia and, to a lesser extent, to China. Thanks to high energy prices, even in the face of significant sanctions pressure, the fall of the Russian economy remains significantly lower than previously expected (the World Bank forecasts it at minus 4.5%), while the foreign trade surplus has reached historical records (for January-September it amounted to almost USD 240 billion). As a result, the situation on the Russian market turned out to be very favourable for Belarusian producers, both due to the emergence of free niches and due to the improvement in their price competitiveness. The latter is due to the weakening of the Belarusian currency against the Russian one by more than 20% on average compared to the beginning of the year.

The recovery of the Belarusian economy is not hindered by some supply-side problems associated with the complication of production chains. For example, according to the official, the tractor production cycle has significantly increased (from 90 days to six months), the automaker Belji has faced an acute shortage of vehicle kits.

At the same time, a deep recession at the end of the year remains a consensus forecast by the expert community. In particular, according to the latest estimates, international structures expect the Belarusian economy to fall by 4-7% in 2022. At the same time, after the primary shock is exhausted, the accumulated secondary effects will begin to put pressure on the economy, and the economy may continue to fall in 2023. Thus, the decline in household income (minus 3.6% over 8 months), which is especially noticeable in industries affected by sanctions, will negatively affect domestic consumer demand. The deep and already long-lasting failure of investments remains a deterrent for the economy - on an annualised basis, their fall exceeded 17% in September. Although some surveys have recorded an improvement in expectations in the business

environment, it is difficult to expect a recovery in private investment in the economy. This is hindered by a high level of uncertainty, increased state regulation, and maintaining high interest rates on loans. In such a situation, only state investments can become a driver for the recovery of investment activity. However, the current situation with budget execution will raise the issue of available sources of financing for public investment.

Significant risks for exports in the near term are associated with the expected deterioration of the global economy in 2023. A possible recession in the US and the EU, a slowdown in the Chinese economy reduce demand for commodities including energy. This, in turn, will affect the Belarusian economy through two channels: through a decrease in prices for goods exported by Belarus, as well as a decrease in Russia's foreign trade surplus.

New sanctions may also create risks for exports: in recent months, the sanctions pressure on Belarus has stabilised, and the economy has shown the ability to adapt to them. So, if in the period from February 24 to May 31 Belarus fell under 4 rounds of sanctions, then in three summer months this happened only once. However, with a certain development of the situation, the tightening of sanctions against Belarus may return to the agenda.

The long-term consequences for the economy are expressed in a significant reduction in its growth potential. Thus, a number of the most important sectors of the country are facing threats of significant degradation. In particular, the IT sector may lose the role of the main driver of the economy. According to official statistics, the reduction in the number of people employed in IT since the beginning of the year has already exceeded 12 thousand people with the total number of High Technologies Park (HTP) employees less than 80 thousand at the beginning of the year. As a result, the industry has been declining for three consecutive months. In July, this ensured a drop in GDP by 0.5 percentage points, in August – by 0.2 percentage points, in September – by 0.4 percentage points. The restoration of the full-fledged work of the potash industry, oil refining and woodworking is also a difficult task for the authorities. The total number of people employed in the economy is also decreasing at an accelerated pace: in July, the number of employees decreased by 85.9 thousand, or 2%. Apparently, this situation is due to the growth factor of migration and demographic problems.

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

If in the real sector there is a gradual improvement in the situation, then in the financial sector, on the contrary, we can talk about the exhaustion of some previously observed positive trends. Thus, the growth of deposits of the population has practically stopped. At the same time, the current level of foreign currency deposits remains significantly lower than the pre-crisis level (by 7.2% below the beginning of the year). Although the rates have decreased, they have not yet reached the pre-crisis level. We can say that the current level of rates does not allow to restore the normal process of accumulation in the economy.

The situation on the foreign exchange market has also changed significantly: the population has ceased to be a stable net seller of foreign currency. Thus, in September, the net purchase of foreign currency by the population amounted to USD 114 million. Such behaviour may indicate a low level of confidence in the banking system and an

increase in the practice of savings in an unorganised form. In terms of net demand from resident legal entities (by USD 224 million in September), non-residents remain the only major sellers of currency.

In the third quarter, the positions of international organisations became consensus that Belarus defaulted on its sovereign bonds. The rating of Belarus was downgraded to “selective default” by S&P agency (the last one that postponed this step). The World Bank transferred all loans to the Belarusian authorities to the status of non-performing loans. Such steps do not create a shock situation for the Belarusian economy, however, they significantly complicate international cooperation (for example, foreign banks massively close limits on Belarus) and push back the prospect of returning to international capital markets.

The authorities have significant problems with the execution of the budget. Although budget statistics have not been disclosed recently, according to the Minister of Finance, the state budget deficit in July amounted to BYN 1.9 billion. This result is the worst in many years, and may be associated simultaneously with the fall in budget revenues (in particular, from foreign economic activity), as well as with rising costs. Indirect evidence of the growing budget problems is the activity of the authorities to raise taxes. The tax increase policy began back in 2020, but if earlier it concerned “small” taxes, now we are talking about the main ones. In particular, a significant increase in the tax burden on small businesses is planned for 2023. The authorities plan to limit the ability of entrepreneurs to pay a single tax and prohibit the payment of taxes under the simplified system, expanding the practice of using income tax by the latter. At the same time, the income tax rate for entrepreneurs is expected to be increased from 16% to 20%, and from 2024 to 25%. It is also planned to increase the single tax rates for the remaining types of activities by 1.5-3 times. In July, the Business Union of Entrepreneurs and Employers reported that the government was also considering raising one of the main taxes, VAT, from 20% to 23%, since the increase in taxes on small businesses is unlikely to bring significant financial benefits to the budget. However, this information has not been officially confirmed.

According to the results of the quarter, we can also talk about a noticeable easing of the budget and monetary policy, which the authorities used to support the economy. The requirements of the National Bank to state bodies on securities since the beginning of the year increased from BYN 197.7 million to BYN 2.52 billion. The practice of quasi-budgetary financing through the Development Bank is also expanding: in August the bond issue limit for it was increased from BYN 2.6 to BYN 5 billion. Also in September, the National Bank returned to the practice of setting standard rates on loans for legal entities and individuals: earlier in March, amid panic, this mechanism was temporarily abandoned. Moreover, since October, the National Bank has significantly reduced these rates (from 20.21% to 17.39% for legal entities and from 22.01% to 18.84% for individuals). Such a move should encourage banks to lend more actively, especially against the background of a record excess of BYN liquidity in the system (at peak times it exceeded BYN 9 billion, which is a historical record).

A side effect of policy easing is increased inflationary risks. Over the past three months, consumer price growth has been in the range of 17-18% with a slight deceleration trend. In fact, we can talk about the stabilisation of inflation at a level that is generally characteristic of the region of Eastern Europe. At the same time, an important

factor supporting inflation is a noticeable BYN weakening against the Russian ruble. In general, such a policy can be characterised as sacrificing monetary stability to exports, which can be considered quite justified in the current situation.

However, the rise in consumer prices aroused sharp dissatisfaction of Aliaksandr Lukashenka at the meeting with the economic officials. As a result, the government introduced a temporary ban on price increases – its violation leads to criminal liability. This moratorium was later replaced by a new control mechanism that severely limits the ability of companies to raise prices. Thus, manufacturers of all forms of ownership must coordinate price increases with various government agencies, and trade organisations are severely limited in the amount of possible allowances. In terms of regulation of trade pricing, we can talk about the return of the mechanisms that were used by the authorities in the 1990s and 2000s and which were later abandoned as part of the policy of economic liberalisation.

This situation vividly characterises the methods currently preferred by the authorities for solving economic problems. Thus, instead of using market levers of control, preference is given to simple and rigid administrative decisions. At the same time, the active use of the practice of criminal punishment contrasts strongly with the previous intentions of the authorities to decriminalise economic crimes, which was seen as an important element in improving the business climate in the country.

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

The current situation is characterised by the deepening of economic ties with Russia and the gradual removal of contentious issues in bilateral relations that have been relevant in recent years.

Thus, it was agreed to allocate a loan from the Government of Russia in the amount of USD 1.5 billion for the implementation of joint import substitution projects. The Russian media reported about the readiness to open the Russian market for Belarusian oil products, which implies the inclusion of Belarusian refineries in the program of subsidies from the Russian budget. With the maximum redirection of Belarusian oil products to the Russian market, the size of such a subsidy can reach about USD 1 billion.

Thus, it can be stated that the scale of preferences for the Belarusian economy from Russia is approaching the level that the Belarusian authorities have been striving to achieve for many years. However, if earlier they could be converted into an increase in exports to the EU, now the growth of support is accompanied by an increase in dependence on the Russian market. In such a situation, Belarus runs the risk of being drawn into the funnel of Russia's immersion in the state of a mobilisation economy.

### **Conclusions**

The economy has overcome the short-term shock associated with a sharp deterioration in foreign trade conditions and began to show signs of recovery. The main positive is associated with the growth of exports, due to a favourable price situation and an increase in sales to the markets of Russia and China. At the same time, medium and long-term risks continue to grow, which could lead to a repeat of the recession in 2023. The policy of the authorities is characterised by the rejection of the achievements of the period of economic liberalisation and the increase in the practice of administrative regulation and tougher penalties for economic violations.

