

Belarusian Analytical Workroom

# **Belarus. Reality.**

*Getting to the heart of the matter*

Issue No. 16  
February 2015

**Andrei Vardomatski**

**Hopes are fading but happiness remains**

**Leonid Zlotnikov**

**Belarusian economy 2014: its own path towards  
a 'landslide'.**

**Anton Shymanski**

**Foreign policy brinkmanship**

**Pavel Usov**

**Political shocks and their implications  
for the Belarusian political space**

© Belarusian Analytical Workroom  
Dr. Andrei Vardomatski  
Warsaw 2015



Leonid Zlotnikov

## **BELARUSIAN ECONOMY 2014: ITS OWN PATH TOWARDS A 'LANDSLIDE'.**

*The president began to raise wages too early. Besides, the economy, which has slowing growth rates, efficiency and market outlets, 'has let him down'. The sovereign credit rating of the country stands next to 'junk', and there is a reluctance to lend. Overall, real wages will be decreasing in the lead-up to presidential elections.*

In September-December 2014, the Russian rouble was devalued. This affected the state of the Belarusian economy, too. Exports to Russia were bringing losses, since trade settlements with Russia were carried out in Russian roubles (except for energy). Lukashenko did not react to business executives' calls to devalue the Belarusian rouble. The devaluation began spontaneously on December 19, when exchange offices ran out of currency to sell to the population. Fearing panic, the National Bank devalued the rouble by about 30%.

Following the devaluation of the Belarusian rouble, Lukashenko blamed all the misfortunes of the Belarusian economy on Russia: *'this one market collapsed and we will dive together with it'*. That being said, the Belarusian economy 'dived' even before the devaluation of the Russian rouble: a steady decrease in the real wages of Belarusians began in August 2014 and wages had dropped by 9-10% by the end of the year. And the devaluation of the Russian rouble had not managed to significantly influence this wage decline. A reduction in revenues from exports to Russia manifested itself as late as in November when revenues dropped by approximately \$300 m<sup>1</sup> compared with both the preceding months and with November 2013. The decrease in export revenues reached a total of \$800 m in November. Lower petroleum prices probably affected the decline in exports to a larger extent than the devaluation in Russia. Belarus has followed its own path towards a 'landslide'. This can be seen from the development trends in the first half of 2014 when events in Russia had not yet impacted the condition of Belarusian economy. The events in Russia simply served to accelerate the process.

### **The real sector is losing effectiveness and markets**

Official statistics reveal the growth of indicators of the real sector of the economy in January-November 2014. Thus, GDP growth constituted 1.7%, the growth of industrial production – 2.2%, agriculture – 2.3%. Freight turnover increased (by 1%), as did the retail sales volume (7.3%). At the same time investment in fixed assets decreased by 10.1%.

GDP growth and the foreign trade surplus were maintained in 2014, first of all by a significant growth in exports of potash fertilisers (by 1.66 times) and, secondly, through the policy of

1 See 'Бюллетень банковской статистики' (Banking Statistics Bulletin) No. 11, 2014r. Table 1.13.

curtailing price increases and tariffs by subsidising expenditure from the budget<sup>2</sup>. Artificial price reduction has brought about a remarkable overvaluation of macroeconomic indicators.

The loss of the competitive edge of the manufacturing industry – the backbone of a contemporary economy – accelerated in 2014. The industry's volume of output and export proceeds decreased in the first half of the year, even prior to the imposition of Western sanctions against Russia and the devaluation of the Russian rouble. The share of machinery, equipment and vehicles as part of Belarusian exports constituted 21.3% back in 2007, 17.2% in 2013 and as little as 14.7% in 2014.

Similar trends can be observed in organic chemistry, too, which was previously one of the country's leading sectors. For example, 'chemical fibres and yarns' used to be one of the most important Belarusian exports back in 2013, but they disappeared from the list in 2014. Another flagship export item – 'tyres' – has remained on the list, yet its export proceeds have decreased by 37%. Food (14.1%) comes second to energy resources (36%) in terms of its share of exports. But its export results in losses for the country (see below).

Price terms of foreign trade continued to deteriorate in 2014. Average prices of exports fell by 3.7%, imports – by 0.9%, compared to the 1st half of 2013. The mass of commodities grew by 2.3% in exports, and decreased by 5.2% in imports.

However, even if we were to believe Belstat (the National Statistical Committee of the Republic of Belarus) that has stated that 2012-2014 (the 1st half) witnessed an industrial output growth of 2.3%, we would note that the entire surplus ended up in warehouses: industrial inventory stocks amounted to 81.4% of the monthly output volume as of July 1, 2014, and 50.7% - as of July 1, 2012.

According to data from the National Bank, volumetric and qualitative indicators of enterprise activity slipped in the 1st half of 2014. For example, revenues of all the undertakings in the country increased by 10.4% in nominal terms in the 1st half of 2014 compared to the 1st half of 2013 and decreased by 7.1% in real terms i.e. when adjusted by the GDP deflator.

All the indicators of financial standing of enterprises fell in the 1st half of 2014 (except for the assets to liabilities ratio, see Annex 1). For example, 3,390 undertakings or 41.7 per cent of their total number did not have their own working capital as of July 1, 2014. This is common of enterprises heading towards bankruptcy.

### **There is a need for more and more foreign currency while it is becoming increasingly difficult to borrow**

Devaluation of the rouble in late 2011 improved the equilibrium of the country's balance of payments for 2012 and decreased the demand for dollars. The real exchange rate of the dollar increased in December 2011 on December 2010 by 34% (the nominal exchange rate grew by 174%). The demand for dollars dropped immediately and the net purchase of currency by the National Bank (NB) on the foreign exchange market exceeded \$2 bn in the 1st quarter of 2012. Devaluation of the rouble was also accompanied by a decrease of 14% in

2 Let me give an example of the extract from a monthly report of the National Bank: 'Key Trends in the Economy and Monetary Sphere of the Republic of Belarus' as of July 2014: 'Agricultural enterprises have consistently encountered financial difficulties. To cover losses related to state regulation of prices and tariffs and to reimburse current expenses in January-June 2014, 2.8 trillion roubles were earmarked from the budget, which constitutes 30.6 per cent of all the financial resources'. Page 33. <http://nbrb.by/publications/ectendencies/>



real wages (by December 2011).

However, the government has not learned its lesson from the 2011 devaluation caused by the growth of monetary incomes of the population prior to the presidential elections (in excess of the economy's capacity in 2010). Since the beginning of 2012, personal income has been growing under the pressure of the president: real personal income increased by 21% in 2012, by 15% in 2013 and by 4.8% in the first half of 2014 i.e. 1.46 times within 2.5 years. At the same time, GDP grew by as little as 2.3%. The real exchange rate against the dollar was sliding in the meantime. Purchasing power dropped by 25% in the period of 2012-2014 (1st half). Devaluation of the dollar (!) continued until November 2014.

The rouble earnings gain of the population did not depreciate due to inflation – as it would appear from economic theory in this situation – thanks to three prerequisites. Firstly, some of the money was diverted from circulation by the National Bank (NB) due to high interest rates on rouble deposits. Secondly, thanks to the sales of the stock of shares of 'Beltransgaz' to 'Gazprom' for \$2.5 bn in late 2011 and a loan of \$1 bn from Russian 'BPS\_Sberbank', the country's gold and forex reserves grew by \$2.9 bn. In the 1st quarter of 2012, the NB bought out \$2.5 bn from the population<sup>3</sup>. Thus, at the beginning of the period under analysis, the NB created a currency reserve. Thirdly, the share of income of the population in the GDP composition increased from 58.8% in 2010 to 72.2% in 2014. Gross external debt increased by \$6.5 bn during this period.

In comparison to 2010, the income of the population grew by \$20 bn (by 27% of GDP) by mid-2014. Currently, in order to maintain the monetary income of the population, a monthly increase of approximately \$1.5 bn is required compared to 2010. \$12 bn of resources drawn from abroad was spent within 2.5 years to ensure the growth of real income.

However, Belarusians find it increasingly difficult to incur new debts<sup>4</sup>. For example, government efforts to place its bonds on the Eurobond market have been in vain for as long as 3 years. And in 2013, the net growth of gross external debt amounted to \$9 bn whereas between the 1st-3rd quarters of 2014 it reached \$1.3 bn (in the 3rd quarter the growth of external debt was negative despite the fact that the gold and forex reserve was approaching the red line). That is why the gold and forex reserves depleted faster in 2014.

### **There is no painless way out of the financial pyramid anymore**

The best way out of the financial pyramid is to effectively use borrowed funds, like a good entrepreneur who invests in a profitable business. He will then reimburse both loans and interest rates from the earnings and will even keep a profit. One can always find a few dozen effective enterprises in the country. However, they 'have little clout'.

One cannot claim that Russian subsidies and external debts have simply been poured down the drain. Belarus had the largest share of GDP among all the CIS countries and one of the largest shares worldwide assigned to investments. For example, the share of investment in GDP amounted to 30% in Belarus, 20.3% in Russia and 22% in Kazakhstan in 2008-2012. In 2010, gross capital formation reached 40% of GDP. Various programmes of modernisation and innovative development are devised and implemented.

3 As a result of the 2011 devaluation, the dollar was probably overvalued. That is why its buy-out by the National Bank did not result in a growth of the dollar exchange rate.

4 The sovereign credit rating of Belarus was 'B-' in October 2014. With such a rating, loans are not granted, as a rule (except for government loans).



However, there is no economic effect from investment. 'While investment expanded, returns on capital have stagnated and even declined in recent years' – World Bank experts concluded. 'This trend indicates that investment growth was associated with inefficiencies in the allocation of capital across the economy'<sup>5</sup>.

The largest investment – nearly \$40 bn – has been channelled into agriculture within the last decade. However, this immense – by Belarusian standards – investment in the sector has changed virtually nothing. Liabilities of agricultural enterprises exceed their annual revenue and will never be settled.

This hopeless lame-duck industry is currently second to petroleum in terms of its share of produce as a proportion of Belarusian exports. Losses from these exports are covered both by the budget and country's population: '...internal market prices exceed export prices: 2.6 times – butter, twice – cheese, three times – eggs. Why such a difference? – the former advisor to the Minister of Agriculture K. Romanovsky writes. – '...Why do we need this? Why, suffering huge losses from exports in milk and meat, spending huge amounts of money from the budget, are we trying to augment it?'<sup>6</sup>

In the autumn of 2014, at the time of the Russian embargo on imports of food from the countries of the West, Rosselkhoz nadzor (the Federal Service for Veterinary and Phytosanitary Surveillance) tightened its controls over the quality of Belarusian food imported to Russia. And it often barred its exports to Russia. As a result, exports of milk and dairy products – key products of Belarusian exports to Russia – were lower in the autumn of 2014 than in the autumn of 2013.

In late 2014, Rosselkhoz nadzor examined the state of sanitary control in Belarusian enterprises and found out that the existing sanitary rules *'were 10 times different from the requirements of the Technical Regulations of the Customs Union on the permissible residual content of antibiotics ...the system of state laboratory control does not ensure control over the content of residues of prohibited and hazardous substances in animal products'*. The proposal of Belarusians to increase supplies of milk and dairy products to Russia in 2015 has been turned down.

A programme of food self-sufficiency is being implemented in Russia. Western sanctions will only serve to bring forward the completion of the programme. It is expected that in 2-3 years from now, Russia will provide for itself with its own produce (except for beef: imports from non-CIS countries are more profitable).

Efficiency in other sectors is not much more superior than the efficiency of agribusiness. The most important thing in Belarus is to meet volume 'target' figures. Since exports of agricultural products generate billions of dollars a year, why deliberate about the efficiency? And Lukashenko orders to build new farms and increase milk production.

Belarus is gradually retreating from the Russian market on all fronts. In the early 2000s, the Belarus' share on the Russian market constituted 9.5%, nowadays it is 5%.

### **Wages will further decrease in the lead-up to presidential elections**

5 Country Economic Memorandum for the Republic of Belarus. Report No. 66614-BY- 5 April 2012

6 Opinion. Belarusians Pay for the Food Exports to Russia out of their Own Pockets. December 13, 2014 <http://news.tut.by/economics/427735.html>

7 See <http://news.tut.by/economics/429620.html>



Numerous modernisation programmes and individual projects have turned out to be ineffective. The latest was the programme of revamping 8 woodworking enterprises launched in 2007. It was carried out under the personal oversight of the president, accompanied by scandals and even the imprisonment of the director of one of the enterprises (in the autumn of 2014). Its completion has repeatedly been postponed. The final deadline is 2017.

The government is trying to revive the Belarusian economy by attracting foreign investment. However, there are no inflows significant for the country's economy. Illusions that high revenues can be generated by privatisation have vanished into thin air. There are only a handful of efficient Belarusian enterprises which can attract buyers. The authorities have been unable to sell half of the stock of shares of one such enterprise (the MTS mobile network operator) owned by the state for the past three years. Besides, it seems that the president is going to defend his socialism to the bitter end and will not allow large-scale privatisation.

Currently, while there are no other sources to cover the current account deficit and manage the external debt, there is the only source left – reduction of family consumption. And it has already been applied since August 2014.

The economic situation in Belarus deteriorates due to lower oil prices and the devaluation in Russia. It was decided in 2014 that Russia would leave oil export duties in the Belarusian budget (\$1.9 bn). This figure is already included in the budget revenue of 2015. However, with oil prices falling below \$70 per barrel, this duty has been set to zero.

Devaluation of the Russian rouble in autumn-winter 2014 exacerbated the situation of Belarusian enterprises which export to Russia. Lukashenko suggested to Russia that contractual prices of goods exported to Russia should be fixed in dollars (whereas payments can be made in roubles, too). However, it is very likely that Russian companies will not buy Belarusian goods in this case as they will turn out to be more expensive than their Russian or Chinese counterparts (Belarusian goods are of lower quality as a rule but they used to be cheaper, like foodstuffs for example).

The president has repeatedly promised the people that there will be no more devaluation in Belarus. This was what he claimed two days before it started, though. Therefore, when foreign currency disappeared from free sales in bank exchange offices on December 19, a new order was introduced on the exchange market as a panic measure on the next day. It was adjusted on the basis of different regulatory acts within two weeks. Devaluation of the rouble had reached 30% by January 10 and perhaps the rate of the rouble has not yet hit its low-point.

A number of government officials (prime minister, his deputies and a number of ministers from the economic bloc) changed in late December. Just a reshuffle in the government. Still, no coherent economic policy has emerged.

Only the operational objective is addressed – not to let devaluation deepen. To this end, measures have been adopted, aimed at: curbing the growth of demand for currency and curtailing rouble supply. These tasks are solved by administrative measures. For example, a government decree<sup>8</sup> strictly forbids trade undertakings to increase prices on all goods or reduce their range of products and it requires that they have analogous goods produced in Belarus on sale. Sanitary and fire inspectorates, the Department of Commerce, the State Control Committee etc. are to control the implementation of these regulations. They are vested with extended powers to punish violators. For example, should a violation in one of

8 The Resolution of the Council of Ministers No. 1207 as of December 19, 2014 'On Issues Related to Consumer Market'



the stores of a given retail chain be detected, all the stores of this chain across the entire country will be shut down (up to 90 days are given to rectify violations). Should a manufacturing facility refuse to supply produced goods for sale at old prices, its manager can be dismissed and prohibited from occupying a managerial position for 5 years subsequently. As stipulated in the resolution, it applies to undertakings with all forms of ownership.

Devaluation was accompanied by the augmentation of the command and control method of managing the economy: 'Enough messing around, making jokes and playing democracy' – the president said when introducing P. Kallaur, appointed as President of the National Bank, to the staff. '...State interests must be above corporate ones'. He recommended that Kallaur should treat executives of private commercial banks as his own subordinates, giving them instructions. And should they disobey, they will be laid off. The president promised to bestow such powers upon him.

The period of validity of decrees and resolutions that consolidate the command system is undefined. It is possible that the president intends to cut entrepreneurial incomes but prevent wage-earner incomes from falling. After all, the year of presidential elections has come, and wage earners have more votes.

**Annex 1** *An extract from the analytical bulletin of the National Bank: 'Key Trends in the Economy and Monetary Sphere of the Republic of Belarus' as of July 2014, p. 26-27*

'In general, throughout the economy, the following has been observed in enterprises involved in all types of activities:

- a nominal growth of revenues and profits from sales of production, goods, works and services accompanied by a lower real growth rate;
- a growth of revenue per average employee;
- a nominal and real growth of the total asset value of enterprises.

At the same time, the following has been characteristic:

- reduction of all profit indicators in real terms and cash balances;
- a growing share of loss-making and unprofitable as well as marginally profitable (by return on sales) enterprises;
- growing net losses of loss-making enterprises;
- reduced profitability ratios;
- a growing amount of budget allocations to cover losses and reimburse running expenses;
- considerable illiquid stocks of finished goods kept at warehouses of manufacturing enterprises and their considerable share in average monthly volume of industrial production;
- reduced individual indicators that characterise the composition of the balance of enterprises, which confirms the remaining problem of insufficient solvency and financial sustainability of undertakings;
- an absolute liquidity ratio (reflects the ability of companies to immediately pay off current liabilities using the existing stock of payment instruments) below the standard value;
- more than forty per cent of enterprises are insolvent (both the working capital financed by equity to total assets ratio and the current liquidity ratio are below the normative standard)
- an increase in overdue payables and receivables; a substantial increase in foreign overdue accounts receivable;
- a growing share of undertakings with debts in arrears;
- diminished current financial solvency;
- an increase in overdue debts under mortgages and loans.