

EXPERT OPINION

February 2024

Summary

- **CONTRARY TO FORECASTS, THE BELARUSIAN ECONOMY HAS SHOWN GROWTH, BUT IT IS NOT SUSTAINABLE**

Despite the GDP growth last year, the economy is not successful from the macro stability point of view. Moreover, considering the reasons for the economic growth last year, this growth is not sustainable either. In 2024, responses to shocks will continue using non-standard methods, thus posing additional risks.

- **BUSINESSES HAVE MANAGED TO ADAPT TO PRICE CONTROLS, BUT THEY ARE UNLIKELY TO DEVELOP UNDER THE SWORD OF DAMOCLES**

The way Belarusian businesses have adapted to working under strict price regulation has shown their high adaptability again. However, businesses feel increasing pressure; and the regulations of Resolution 713 hang like the sword of Damocles over a significant share of companies. A long period of strict price regulation will jeopardize the development of Belarusian businesses.

- **GLOBAL ECONOMY IS TRYING TO FIND A NEW EQUILIBRIUM IN THE MIDST OF THICKENING THREATS**

The global economy has demonstrated resilience and high adaptability to serious turbulence over the past two years. There was no recession last year; and expectations for this year lean toward a soft landing. The currently observed weakening of economic activity looks like an attempt to find a new equilibrium after a series of heavy shocks and in an environment of fragmentation of the global economy. This leads to a base scenario in 2024: a weak growth with elevated but slowing inflation. However, at the same time, the list of current global risks is very wide; and the likelihood of events developing under negative scenarios is higher than usual.

CONTRARY TO FORECASTS, THE BELARUSIAN ECONOMY HAS SHOWN GROWTH, BUT IT IS NOT SUSTAINABLE

A top manager of one of the banks who wished to be anonymous

Growth was driven by cyclical factors in 2023

The Belarusian economy completed 2023 with more successful indicators than its prospects that had been seen a year before (GDP grew by 3.9% against the 3.8% target). Most of the reasons that contributed to this were cyclical rather than fundamental in nature. Firstly, this was expanding demand in Russia (a key trade partner of Belarus). Once disaggregated, the sectors that are tied to the Russian market (defense industry, in particular) are doing best. Secondly, this was the “successful” money-issuing attempt of the National Bank, which in principle could be considered a political failure of the regulator. At the same time, there is some investment recovery — versus a low baseline — due to state budgetary and quasi-budgetary sources. This factor is also temporary and unstable. The population's slightly calmed inflation expectations and the expansion of demand, which resulted largely from consumer lending stimulation, also had an impact.

If you look at history since the 1990s, you will see that the cyclical component was at its maximum in recent months, maybe a little longer, in Q3-2023 or in Q4-2023.

Economic policy was ad hoc

It can hardly be said that last year's economic growth was possible thanks to the pursued “economic policy”. Moreover, such a policy — in its classical definition — was not observed. Decisions were ad hoc, taken even reflexively, as a reaction to external factors: sanctions and counter-sanctions. I would not consider the indicators that were achieved through administrative restrictions, directed lending, and money issuing, as successful. Moreover, I would not say that it is possible to achieve long-term goals in this way.

The government managed to meet its 3.8% economy growth target. Moreover, it seems that there was an “overflight” at the end of the year, and there was a task to move part of this growth to 2024 so as not to have a high baseline.

It is definitely impossible to talk about success from the point of view of macro stability. This is because in pursuit of indicators, an inflationary overhang has formed. Is this sustainable in the long run? Definitely not, because the saving behavior of households and firms has not changed. Households and firms continue saving their remaining liquidity in very “short” money.

There was a certain stabilization illusion illustrated by the historical records of “de-dollarization” in connection with the policy of moving away from “unfriendly” foreign currencies. However, it is completely unclear

what had a greater effect: this policy itself or the sanctions, due to which the demand for primarily assets in euros fell. At the same time, I do not see any successful policy of replacing the euro and the US dollar with “friendly” foreign currencies. Practically, the only alternative to these currencies was the Russian ruble. However, attracting sufficient Russian rubles to the Belarusian market failed. Accordingly, there are no reasons to talk about any stable sources of financing either.

Another questionable indicator (the authorities refer to the successful economic policy in 2023) is the record-breaking Br 4.75 billion budget deficit envisaged in the 2024 budget.

The National Bank no longer influences the pursued policy

I consider 2023 as the point when the National Bank finally lost any influence on the pursued policy. The policy was quite controversial throughout the year. At the beginning of the year, the regulator actually announced that it was targeting monetary aggregates. In essence, this is one or even several steps back. Actually, central banks in two neighboring countries at war are an order of magnitude ahead both operationally and politically. There they are involved, among other things, in inflation targeting and “fine-tuning” regulation. At first, the National Bank of Belarus announced some basic directions of a unified state monetary policy, including requiring banks to increase lending in the range of 17-21%. At the end of the year, when realizing that an overhang had formed, the National Bank was unable to publicly acknowledge the risks. Just as it was unable to stop money issuing, which was actively proceeding through all three channels (purchase of government securities and currency, lending to banks).

The foreign exchange rate regime, essentially tied to the Russian ruble, also drove the economy into a trap. The National Bank could not escape this tie. This led to the fact that during the periods of devaluation of the Russian ruble in the foreign exchange market of the neighboring country, the Belarusian ruble also depreciated against the currencies of the countries from which the bulk of imports came (at the same time, there was a strengthening of the Belarusian ruble against the Russian ruble in the export market). That is, this problem has not been solved systematically either.

Now we see that the National Bank is trying to somehow restore the operating model of the monetary policy, in particular through restoring the rate corridor. However, at the same time, the refinancing rate remains unchanged (9.75%); one might say that it is non-functional. It turns out that the regulator is trying to take workarounds instead of using standard tools to tighten its monetary policy. Another decision made by the National Bank — tightening the mandatory reserve fund requirements — is generally a kind of archaic phenomenon, probably peculiar only to third world countries. The mandatory forex reserve requirement is now set at 18%. This is an even more strange measure,

since similar measures are applied both to “unfriendly” foreign currencies and to the Russian ruble.

In general, this focus on non-standard tools in macro-regulation (while simpler and “honest” methods could be used to address challenges) has been expected, given that we have observed this trend over the past years. I do not think this is due to misunderstanding or deliberate policy. It is possible that this is a consequence of lacking competencies. If that is the case, it is scary enough, and this is becoming a systemic problem.

Economic growth is unsustainable

Considering the reasons for the economic growth last year, this growth is unsustainable. The situational environment that contributed to it is unlikely to replicate in 2024. In fact, everything that worked positively in 2023 shaped a high baseline, and it is unlikely to grow as significantly in 2024. The growth drivers were two sectors: manufacturing and wholesale / retail trade. It is quite clear that this is partly due to the process of recovery growth, including the exports of potash fertilizers and petroleum products. Largely, the external market environment, including high demand from Russia and the prevailing price parameters, had a significant impact.

The prospects for the potash fertilizer sector depend not only on the global market prices, which dropped noticeably in 2023, but also on logistics capabilities. In fact, Belarus has only one channel left to ship potash fertilizers: Russian seaports. However, logistics to the East are limited, including because they intersect with the flow of “military” supplies. Therefore, I think Belarus has almost reached the ceiling in terms of increasing supply volumes. As for prices, there are no grounds for their significant growth yet.

What will be special about 2024? It is evident that the sanctions regime continues, as well as military operations. However, at the same time, this is an election year in Russia and the year of certain turbulence in the foreign market. Belarus will also be preparing for the 2025 presidential election.

I can see the following key risks in 2024:

- exhaustion of temporary cyclical factors that were effective in 2023;
- a formed inflationary overhang;
- unpredictability of the Russian ruble exchange rate after the 2024 presidential election in Russia;
- unpredictability of regulators' responses.

Theoretically, we can also talk about the external debt issue, but at the same time, there are certain expectations of receiving serious support from Russia. Therefore, this risk exists, but its likelihood is low.

Non-economic goals come first

Another specific risk, which can be seen based on the last year's experience, is the desire of the authorities

to set clearly illusory goals and achieve them with very non-standard tools, while avoiding solving real problems, developing “correct” policies and adopting a traditional package of measures familiar to economists.

We already understand that responses to shocks will continue being completely non-standard, unpredictable and unevenly working (for various agents: individuals, state-owned enterprises, the private sector) both in the economy and in the banking system.

In recent years, there has been a significant distortion in the balance of economic and political goals (in favor of the latter). One gets the impression that not a single significant economic loss (e.g., losses in Belarusian retail chains, losses in a commercial enterprise or losses in the real sector, or labor force outflow) seems significant when compared with achieving short-term non-economic goals.

Therefore, the continuation of such a policy is also one of the key risks in 2024 and subsequent years. At the same time, the consumer — the average person — may temporarily remain satisfied, because visible parameters (inflation, in particular) will be kept at attractive levels. It is very likely that neither the losses of enterprises nor any economic problems will be considered as a significant price for achieving the desired indicators. Moreover, apparently, there is no clear feedback received by decision makers.

The statistical illusion that such measures to curb inflation are effective creates the risk that they will be used in the future. I think that the chosen method of administrative price regulation will expand in one form or another in 2024, even at the cost of the revenues and financial performance of enterprises.

BUSINESSES HAVE MANAGED TO ADAPT TO PRICE CONTROLS, BUT THEY ARE UNLIKELY TO DEVELOP UNDER THE SWORD OF DAMOCLES

Government position

The government's motivation for introducing strict price regulations in 2022 was absolutely clear. Rising prices are one of the most troubling issues for the population. This is evident in numerous household surveys. Not every person can notice economic growth or its absence, and rising prices are perceived by households more painfully than the joy associated with rising wages. In view of the war outbreak in the neighboring country and disruptions in production and logistics chains, many manufacturing and trade businesses were unable to ensure the delivery of goods on schedule and at previous prices. Delivery times and costs increased, and, as a result, production costs grew. Therefore, an increase in prices was inevitable in this context. In addition, some companies were unable to rebuild their supply chains and stopped either importing

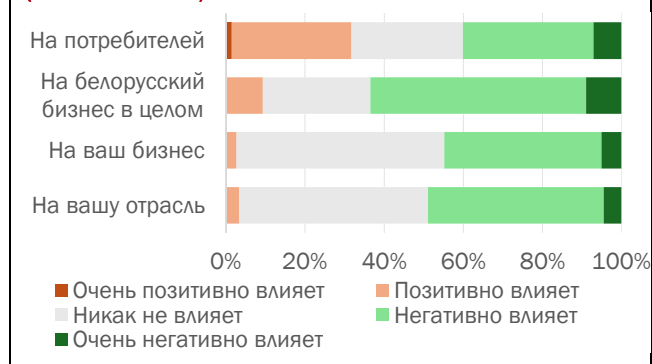
or producing some goods. In this context, those companies that managed to find new channels and establish new supply chains could dictate their prices in the domestic market before the authorities began to implement strict price regulations. While monitoring the situation in real-time, the state decided to regulate prices manually or, as claimed, “to trim the fat” from trading and manufacturing companies. Therefore, the idea of containing prices was implemented precisely in the interests of the population and at the expense of corporate profits, and the public generally supported this.

How did businesses perceive these measures?

A business survey conducted shortly after the adoption of Resolution 713 at the end of 2022 showed that companies realized that end consumers would benefit most from its implementation. Businesses, which had always been interested in legislative stability, quite expectedly found themselves in a stressful situation due to a sharp change in the rules. The need to quickly restructure business models caused a bit of a shock.

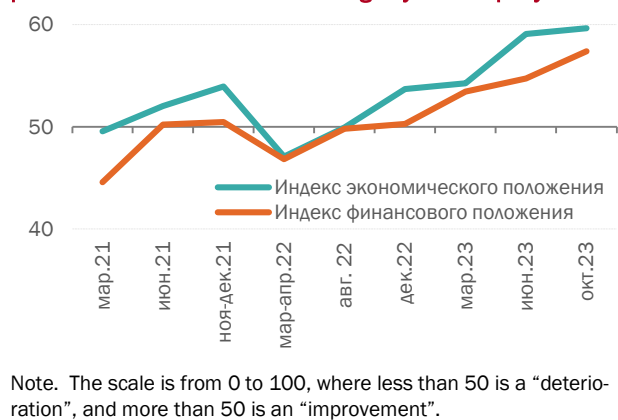
Meanwhile, business surveys on this situation showed similar trends with the perception of other challenges: the impact was perceived as maximally negative for the entire economy, but in relation to one's own company, it was no longer seen so badly. In December 2022, almost 63.3% of respondents believed that price regulation would have a negative impact on Belarusian businesses in general. When asked how it would influence their sector, 48.9% of respondents already said it would have a negative impact. When answering the question “How will it influence your business?”, a little more than 44.7% of respondents answered the impact would be negative (Figure 1).

Figure 1. Impact of the price regulation situation (December 2022)



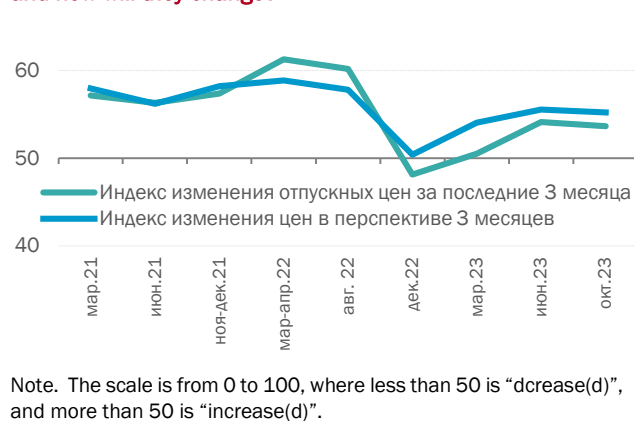
Importantly, businesses' assessments of their economic performance and financial standing have been steadily improving since August 2022. These assessments had no leap associated with the beginning of price regulation (Figure 2).

Figure 2. How would you assess the current economic performance and financial standing of your company?



If you look at the change in selling prices, there was an obvious abyss in the December 2022 survey, when businesses — for the first time in a long observation period — noted an actual decrease in their own prices. The following survey in March showed that expectations for an increase in selling prices returned to the growth zone (Figure 3).

Figure 3. How have your company's selling prices changed, and how will they change?



Therefore, businesses found ways to adapt in the context of strict price regulation and they could raise their prices to the level at which the economic performance and financial standing of the companies did not worsen. The growth of household incomes and loose monetary policy facilitated this, too.

In essence, the usual scenario of Belarusian businesses adapting to external shocks materialized. Yes, it was difficult and unusual. It was especially difficult for small companies that did not have sufficient human resources and competencies to reconfigure their entire business model to adapt to new conditions, and this was especially true for individual entrepreneurs. At the same time, some firms, especially large ones having a serious staff of economists and programmers, managed to adapt their business to new rules. As a result, this became their competitive advantage. In addition, some companies began to reorient to exports allowing themselves to compensate for lower profitability in the domestic market.

The trade sector suffered the brunt of the introduction of tight price regulation, but producers also faced consequences, as purchase prices were rising, wages had to raise to retain staff, and changes in the foreign exchange rate were poorly predictable. All this greatly increased the cost of goods. As a result, there was less and less “fat” that could be “trimmed” from them.

As a result, at the end of 2023, business surveys included price regulation among the top 5 barriers to doing business, and the abolition of regulation along with the regulatory stability were named among the most important factors that would foster development. This was because by that time, the recovery growth potential of the economy had exhausted, and profitability of many businesses fell below an acceptable minimum value. At the same time, expectations of businesses regarding changes in their future economic and financial conditions began to decline.

Belarusian businesses demonstrated their adaptive capacity again

If we compare the indicators of unprofitable legal entities in January–November 2022 and in January–November 2023, then in the trade sector, which was most susceptible to negative impacts, the share of such entities increased by 4 percentage points. 19.7% of companies were unprofitable in trading in January–November 2023. However, it is not entirely correct to take 2022 as a reference year because of multiple shocks both for the economy as a whole and for individual Belarusian companies. By the way, these shocks turned out to be very positive for some businesses: many competitors exited the markets of Belarus and Russia. If we compare this with the last “normal” year, which was 2019, then the share of unprofitable legal entities in the trade sector increased by 2.6 percentage points. This was a non-critical change against, for example, the backdrop of the increased share (by 9 p.p.) of unprofitable enterprises in the ICT sector over the same period. On the contrary, there has been a drop in the share of unprofitable enterprises in the manufacturing industry and agriculture by 5.3 p.p. and 6.6 p.p. respectively since 2019.

Therefore, the government believes that “nothing terrible” has happened to businesses, while administrative price regulation has helped curb inflation. The state, the population, and economists were again convinced of the high adaptability of Belarusian businesses demonstrated in practice in the face of another crisis.

However, there is another important point. This means that Belarusian businesses have been put in the position of begging the state. All the approvals and notifications make businesses very vulnerable to the decisions taken by the government authorities, and the well-being of companies largely depends on them. As numerous surveys of Belarusian businesses have demonstrated, private companies have always wanted to be as far as possible from the state, to ask for less, and

for the state not to interfere in their business. Today, many companies realize that it is almost impossible to meet all the requirements of Resolution 713 (and there is also Resolution 114 on regulating prices for the goods used in agricultural production), which, moreover, change quarterly. Businesses understand that they are under the constant threat that the state will find formal violations of the law as far as any commodity item is concerned. Along with reducing profits, this will hinder the development of companies: they will most likely avoid expansion and refuse to invest in this environment.

In other words, companies know how to adapt to new conditions and survive, but they feel growing pressure, and the norms of the Resolution (“On the Price Regulation System”) hang like the sword of Damocles over a significant share of Belarusian companies.

The chosen methods of price regulation will not be abandoned in the near future

According to the rhetoric of the authorities, an important goal (not only of the Ministry of Antimonopoly Regulation and Trade (MART), but of the National Bank, too) will be to curb price growth in 2024. There is no reason to expect a quick termination of Resolution 713. It is likely that it will be amended quarterly in order to balance the interests of consumers, businesses, and the state.

This will force some companies and individual entrepreneurs, who have not managed to adapt, either to exit the market or to refocus on other goods and export markets. Others will replace them — those who have managed to reengineer their business models adapting to new conditions.

It is obvious that a long period of strict price regulation will jeopardize the development of Belarusian businesses: shrinking profitability along with unpredictable legislative changes and the threat of punishment for non-compliance with difficult-to-comply standards will affect business activity.

THE GLOBAL ECONOMY IS TRYING TO FIND A NEW EQUILIBRIUM IN THE MIDST OF THICKENING THREATS

The 2024 base scenario for the global economy is about weak growth with elevated but slowing inflation

The global economy has demonstrated resilience and high adaptability to serious turbulences over the past two years. There was no recession in 2023; and expectations for 2024 lean toward a “soft landing”. In other words, excess demand, especially in developed countries, which resulted from excessive fiscal and monetary stimulus during the pandemic and which overlapped with structural changes in the labor market, did

not collapse quickly, but it has been dissolving gradually. As a result, the currently observed weakening economic activity looks like an attempt to find a new equilibrium after a series of heavy shocks and in an environment of global economy fragmentation.

The 2024 base scenario is sluggish growth in the global economy, especially in developed countries: about 1-2% in the US, and about 1% in the EU. Developed economies have gone through the sharpest interest rate hike cycle in the past two years; financial conditions have tightened strongly, and their contraction effects will be felt quite strongly this year.

China's economic growth has been slowing down steadily: we can expect it to be in the range of 4-5% this year. The population in China has begun to decline, and it has been rapidly aging; there are many unresolved issues in some sectors of the economy; the corporate sector debt has reached 168% of GDP, and — together with the liabilities of households and the government — it has reached almost 290% of GDP. At the same time, China has been moving towards digital totalitarianism, which does not foster growth potential.

Russia is very unlikely to avoid a strong slowdown in its growth this year. The economy is overheated: in Q4-2023, Russia's GDP was ca. 3% above its balanced level, its production capacity was 81% loaded (a record-breaking figure in the 21st century), and there is an unprecedented shortage in the labor market. Fiscal incentives (that are largely related to financing military and social spending) will gradually weaken, although they will remain. A noticeable tightening of monetary conditions will have an additional dampening effect on demand. Accordingly, it seems most likely that the growth of the Russian economy will slow down from about 3.6% in 2023 to 1-2% in 2024.

Cooling global demand will limit the space for rising commodity prices in the world. I would not rule out a further decrease in the fertilizer cost, which is sensitive to Belarus.

If there is no pressure from global commodity prices and weakening economic activity, the downward trend in inflation in developed countries (but not only in them) is likely to continue this year. However, global consumer price growth is likely to remain higher than the growth rate in the previous decade. Supply-side factors related to the fragmentation of the global economy and structural changes in the labor market will facilitate high inflation.

The predominance of pro-inflationary risks will determine the conservative approach of central banks to lowering interest rates. Moreover, this will be an election year for a record number of people on the planet. I am inclined to believe that the fight against inflation in such conditions will be much more important than the problem of slowing economic growth, since voters feel the effects of rising prices much faster and more acutely. Consequently, key rates will decline rather

slowly, gradually approaching their neutral values in several years (if there are no heavy shocks).

The 2024 base scenario looks more negative than neutral for Belarus. Demand for Belarusian exports will grow slower. It may even decrease due to increased competition in the Russian market and/or in the event of tightening of secondary sanctions or the methods of overseeing their enforcement. Price support for exports is not expected either. At the same time, pressure on consumer inflation may continue in Belarus, since price growth in the key trading partner countries of Belarus, primarily in Russia, is expected to be elevated.

The risks of developing under negative scenarios is higher than usual

The above base scenario seems to be the most realistic under current conditions. However, its likelihood is now lower than usual in the base scenario, since there are many more factors of uncertainty that can turn everything upside down. It is hard to say whether the global economy will be able to overcome the obstacles that have arisen and get back on track of balanced development without major losses.

The tense global military-political and social situation shapes the main risks and threats to economic development. We can already see polarization in society. If uncertainty is that high, military-political conflicts affect both the material and psychological state of people. When all this is coupled with the elections impacting over half of the global population, then some surprises are extremely likely, and the global economy would have to pay a lot for them.

Two potential risks can be identified. The first surprise could be the likelihood of a "hard landing", i.e. a significant global downturn and recession. The push could come from China with its bloated domestic corporate debt and chronically troubled construction sector. The push could come from the US or the EU, where political risks are quite palpable and the negative impact of high interest rates on the financial position of banks, firms and households may be stronger than expected.

If the trigger for a global recession or a strong slowdown in global economic growth is the expansion of any military-political conflict, then it will be difficult to respond by using conventional methods (lowering interest rates, large liquidity injections, intensifying budgetary incentives). Continuing high inflation limits the space for such maneuvers. This is the second risk coupling with the first one: namely, the likelihood that inflation will be higher than projected; and instead of slowing down, it will remain near current levels or even rise.

Any aggravation of military-political conflicts, especially in the Middle East, will be associated with supply chain disruptions and a possible reduction in energy commodity production. This in turn will lead to a strong increase in inflationary pressure in the world. A good ex-

ample is the situation in the Red Sea, which has already increased the cost of maritime transportations almost three times compared to December 2023.

If it is impossible to quickly stop such a conflict and it develops into a full-scale one (with the involvement of new countries), this will increase the cost of raw materials and lead to an even greater and sustainable increase in the cost of transportation. This in turn is fraught with an imbalance in supply and demand for goods, as well as an increase in inflationary pressure globally.

The likelihood of these shocks is higher than usual, while the chances for the base scenario to materialize are lower. If any of the negative shocks occurs, we will see a kind of a stagflationary scenario with a negative impact on economic activity associated with a new round of pressure on prices. In such an environment, central banks will be reluctant to cut interest rates, and it will be more likely that interest rates will remain elevated for a long time. On the one hand, this is a way to fight inflation, but on the other hand, this poses risks for financial stability and debt sustainability, especially in developing and low-income countries that rely on foreign currency borrowing and have little room for fiscal maneuvers.

Such strong external inflation shocks (if they materialize) will significantly limit the ability of the Belarusian authorities to curb price growth by administrative levers and will require softer price controls due to the inflationary overhang accumulated by the beginning of 2024. Otherwise, the financial standing of enterprises has a risk of deteriorating to such an extent that a series of non-performing loans, non-payments and bankruptcies may begin. This, in turn, can spread to banks and provoke a large-scale financial crisis.

Lowering intensity of global cooperation poses additional and serious risks to the development of the global economy in general and to the economy of Belarus in particular

Another risk to dynamic development (probably a more long-term one) is the fragmentation of the global economy associated with the cooling of the globalization process. Many countries have been trying to bring home part of their production, and production chains that have been established over decades are changing. If such decisions are forced by political rather than economic reasons, then they may turn out to be economically ineffective. This increases the risk of persistently high global inflation as the benefits of using cheaper labor diminish and costs rise.

The need and usefulness of the global division of labor are also dictated by the particularities of different cultures. Values (i.e. certain orientations and behavioral attitudes shared by the majority of people) differ among cultures. It is much more difficult (if not impossible) to develop dynamically while isolating yourself in closed systems. Different values predetermine the impossibility of producing the necessary goods and services equally well in each country or even in integrations of independent states. That is why the chilling of globalization processes witnessed today may be a kind of cyclical fluctuation, like in case of output. That is, these processes developed so rapidly at the end of the last century and at the beginning of the current century that they might have reached the overheating phase. Now we see some kind of correction and attempts to find balance. It is quite possible that in a few (perhaps more) years we will see a new round of strengthening international cooperation.

The fragmentation observed today is a big challenge for Belarus. By closing in on oneself and on Russia, it will be difficult to develop, and it will be unrealistic to count on a sustainable increase in the rate of economic growth, at least to the world average value. Currently, the sustainable growth of the Belarusian economy is about 1% per year, and if you try to develop in isolation, then you can forget about any growth acceleration, which will inevitably lead to a deterioration in the quality of life in Belarus versus neighboring countries.

Therefore, today it is extremely important not to completely lose the competencies and advantages that will help the country effectively integrate into global production chains when globalization processes pick up their speed again and lead precisely to development, and not to stagnation.

The key advantage of Belarus is its people and human capital. Rapid development of the IT sector until 2022 and the digitalization process, especially in the banking sector, have shown that Belarusians can generate creative solutions to problems and develop niche innovations to a greater extent than the mass production of standard products. However, we are losing people physically (they migrate, and unfavorable demographic trends have an effect). This is compounded by the erosion of human capital due to problems in education, healthcare, and loss of trust. Today Belarusians have an objective not to lose these competencies, because in the future, this could become our competitive advantage and help us integrate into new global chains. This means turning towards quality growth.