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Editorial

In this issue of showCASE, we discuss the future of the Belarusian economy following the political turmoil of the August 2020 presidential elections in the country.

Against the background of growing global uncertainty and deepening macroeconomic instability in Belarus, a true dialogue between the two sides and organisation of new, free, and fair presidential elections in the nearest future appear as the only options to ensure quick economic recovery in 2020-2021.

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Belarusian economy at the crossroad – three scenarios for the near future

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The presidential elections that took place in Belarus on August 9th, 2020 were incontestably the most controversial ones in the modern history of the country. Jailing and banning key election rivals, lack of transparency, and multiple recorded falsifications during the votes counting (the incumbent Alexander Lukashenka claimed an improbable 80% of the vote[1]) predictably angered the Belarusian people. As excessive and unlawful use of force against peaceful demonstrators after the election results were announced only added fuel to the fire. Since then, Belarusian citizens have mobilised on an unprecedented scale. Every day thousands of people have been protesting against Lukashenka despite hundreds of them if not thousands being imprisoned on a weekly basis. Every Saturday, Women's March gathers roughly ten thousand women. Every Sunday, over 100,000 people all over the country take part in National Marches. The protests have already lasted for over eight weeks.

What does this political turmoil mean for the near future of the Belarusian economy? Will the economy survive if the protests continue? What will be the key to economic recovery? We look at three different political scenarios and explain what economic outcome is most realistic for each one of them.

Based on the analysis of the previous crises in Belarus, we explore performance of several indicators – such as Belarusian rouble (BYN) nominal exchange rate, inflation rate, bank liquidity measured by interbank 1-day credit rate, and investment growth rate – as measures of the impact of political decisions on the country's economy.

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As a starting point, let us briefly describe the situation shortly before the elections. Belarus' GDP over January-July 2020 contracted by 1.6% y/y, among others due to the impact of COVID-19 pandemic crisis on the global economy and oil and gas tensions between Belarus and Russia. Despite high liquidity in the banking sector – average interbank daily credit rate stood at record low 3.5% in July (compared to 10.6% in July 2019), the investment in the economy over January-July

[1] According to preliminary results of the public opinion poll conducted by the Chatham House at the end of September 2020 using computer assisted web interview method, his main rival Sviatlana Cichanoŭskaja (Sviatlana Tsikhanouskaya) in fact won, gathering 52.2% of the votes (to be published later in October).

2020 fell by 0.5% y/y. The Belarusian rouble had been losing value vis-à-vis euro since the beginning of 2020, but the year-on-year inflation (CPI) was up to 5.2%, exceeding only slightly the 5% target of the National Bank of Belarus (NBB) for 2020.

Scenario 1: Economic crisis if no dialogue at all amid ongoing protests

Should the political situation in the country remain unchanged, with daily and weekly protests, no signs of dialogue from Lukashenka, and police continuing to brutally pacify the protests and arrest scores of people on a daily basis, we predict that by the end of the year the Belarusian economy will be in a state of total disarray.

The most recent data from August and September give an indication of how it might look like. The uncertainty caused by political tensions prompted people and businesses alike to withdraw transferable deposits and other bank deposits in domestic currency in the sum of BYN 1.6 billion (11.5%) and in foreign currencies in the sum of USD 375 million (3.3%) in August 2020 alone. This, in turn, resulted in a record-high demand for foreign currency (USD 1.5 billion net demand from individual persons and USD 1.4 billion net demand from legal entities in January-August 2020) as well as an accelerated consumer price growth (5.6% year-to-year in August). As a consequence, the average monthly nominal exchange rate of the Belarusian rouble to euro went down by another 9.9% in September 2020 compared to July 2020, and the one-day interbank credit rate hit 25% on September 7, 2020 (compared to 4% on August 7, 2020). The latter was caused by the reaction of the NBB, which aimed at stabilisation of the Belarusian rouble (the NBB suspended available liquidity regulation operations in the national currency).

Unsurprisingly, the overall climate of uncertainty, compiled with low bank liquidity in August, resulted in a drop in investments by 9.0% in August[2]. Should the political status-quo prevail throughout October, November, and December, the pressure on BYN exchange rate will likely further increase, inflation will accelerate, and liquidity shortages inside the banking system will get worse.

The NBB international reserves shrunk by USD 1.4 billion (15.8%) over the month of August, leaving USD 7.5 billion as of September 1st, out of which foreign currency reserves constitute only USD 3.2 billion. Continuous interventions by NBB might result in further significant depletion of reserves in September.

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Keeping in mind the abovementioned trends along with the second wave of COVID-19 pandemic and its impact on global and Belarusian economy, a full-scale economic crisis by the end of 2020 is inevitable without foreign lending. But there is a big question mark over Belarus' ability to secure any kind of lending under current political circumstances and even if it does succeed in doing so, it is likely to be at prohibitive interest rates.

[2] Own calculations based on the official data.

Scenario 2: Economic stagnation if Lukashenka fakes dialogue and the society is divided

Most recently, Lukashenka announced a constitutional reform will be carried out by 2022. For his opponents, this is, however, not enough. What is crucial, is conducting fair elections. According to Lukashenka's key political rival, Sviatlana Cichanoūskaja, and the Coordination Council in Minsk, any kind of constitutional change will be possible only if there is a fully legitimate president of Belarus in place. Otherwise, any constitutional reform will be just as illegitimate as the 2020 presidential elections themselves.

> To put it briefly, without a comprehensive political dialogue between Lukashenka and the civil society, the economic outlook for the country is rather bleak.

Nevertheless, a constitutional reform might become one of the main subjects of a dialogue between the two sides of the political conflict. If this is the case, the line between anti- and pro-Lukashenka groups in the Belarusian society will become more pronounced and thicker. Unfortunately, such a division might cause the political tensions last much longer, maybe even years to come – to the detriment of the economy.

Even if the National Bank of Belarus together with the government will somehow manage to find macroeconomic balance in the short-run (coming 5-6 months), there will still be little reason for the investment – and, consequently, GDP – growth. No rational business will invest or reinvest in a country with such high political risks, a most recent issue on a long list that includes lack of transparency in decision-making, Internet blockage, administrative control over the third largest private bank, little-to-no tourism, overcrowded prisons, and talented youth leaving the country.

What would be expected in the country in the coming years instead is a rise in the shadow economy, oligarch-driven investment, brain drain, high pension burden, and macroeconomic instability. The situation might be further deteriorated by the general uncertainty regarding global economic growth due to the Covid-19 pandemic and unstable commodities markets (oil products and potassium are key export goods for Belarus).

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Scenario 3: Economic recovery if new presidential elections are held

In our opinion, the only scenario in which the economy experiences recovery in 2020-2021 is the commencement of a true dialogue between the two sides of the political conflict and, crucially, organisation of new, free and fair presidential elections as soon as possible.

In economic terms, in order for the Belarus' economy to return on the path of growth, three key goals would need to be achieved:

- Macroeconomic stability with 1-digit inflation, exchange rate under control, and normal operational bank liquidity.
- Preparation of a detailed plan of economic recovery for the coming years that includes some urgent economic reforms (for instance, social protection system reform, decriminalisation of minor economic offences, equal treatment for private and state-owned enterprises, state-owned enterprises restructuring, simplification of the trade regime with the EU, USA, China and other countries, and financial sector

liberalisation).

- Creation of an international financial anti-crisis fund of USD 10-12 billion[3] to support both the macroeconomic stability measures and recovery plan.

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All these can be achieved concurrently only if Lukashenka and the Coordination Council sit at the negotiating table. Many experts agree that the team currently running the National Bank of Belarus and the Ministry of Finance is highly professional and well equipped to resume macroeconomic stability. The negotiations would enable a joint team of professional economists representing both sides of the conflict to put together a comprehensive plan of economic recovery, which would also appeal to the Belarusian and foreign investors, and international financial organisations. Financial support may come from the European Union or a troika (EU-Russia-China) under the condition that the negotiations result in a clear political consensus. Financial support would also surely pour in from the Belarusian diaspora from all around the world.

In the period of political crisis, the government could only think of short-term stability and can hardly implement reforms. This is why so far Belarusian economic authorities are trying to achieve only the first goal (macroeconomic stabilisation). What about the rest?

Now is the best time to start a dialogue and work towards achieving a solution acceptable and beneficial to all the Belarusian people. The longer Lukashenka waits, the more difficult – and expensive (financially and otherwise) – it will become.

[3] Own calculations based on estimated costs of foreign debt servicing, exchange rate support, fiscal balancing, and key reforms for the rest of 2020 and 2021.

Highlights

Trade, Innovation, and Productivity

On September 8th, the European Commission published a proposal for a regulation on the elimination of customs duties on selected EU imports from the United States (US) worth about USD 200 million per year. The initiative is to be reciprocated by an equivalent reduction on the EU exports to the US. The decision is in line with the August 21st Joint Statement of the US and the EU that launched the first in decades negotiations of duties redaction between the partners. In substance, the initiative will cover the elimination of tariffs on imports of US live and frozen lobster products worth USD 111 million a year to the EU. On the US side, it will include a 50% duties reduction on prepared meals, crystal glassware, surface preparations, propellant powders, lighters and lighter parts. The ultimate objective of the Tariff Agreement is to unlock new opportunities for the EU and US companies, improve trade relations, and mitigate ongoing disputes between the partners. While the agreement will have a negative impact on the budget of the EU in the form of foregone duties, the Single Market would benefit significantly from improved access of the EU exports worth about USD 160 million a year.

Labour Market and Environment

Vocational education and training (VET) aims to provide adults with skills relevant for the labour market, personal development, and social inclusion. It is perceived as one of the most important EU tools to boost entrepreneurship, competitiveness, research, and innovation within the Single Market. Its relevance and role have been strongly emphasised throughout the European Commission's ambitious agenda on the COVID-19 market recovery. Further, the recent European Commission's activities dedicated to the improvement of VET performance and development of digital skills among adults through VET have already been introduced via selected EU-level programmes (e.g. Erasmus+). Nevertheless, as CASE DEEP project results show, the barriers for digital transformation do not only lay on the side of individuals or the VET providers. The reluctance to engage in the digital transformation and VET systems, therefore, is strongly observed at the local and companies' levels. Thus, engagement of different stakeholders (including private sector and local authorities) into the transformation of the VET practices and inclusion of digital skills within the Single Market is necessary for the effective implementation of the EU policies and activities.

Macro and Fiscal

On September 17th, Polish Minister of Finance, Tadeusz Kościński, presented in the Sejm the amendments to the 2020 annual budget triggered by the COVID-19 crisis. The Ministry expects that the budget deficit may amount up to PLN 109.3 billion, which will be about 5% of the Polish GDP. The objective of the balanced budget assumed before the pandemic will not be met due to both increased expenditure (up by PLN 72.7 billion) and decreased revenue (down by PLN 36.7 billion). The main source of revenue, i.e.

VAT, will bring PLN 26.5 billion less than envisaged earlier. The new VAT revenue assumptions are in line with CASE's forecast. The drop in Poland's GDP is expected to translate into increase in the VAT Gap by nearly 5 percentage points up to 14.6% of the VAT Total Liability, which will inflate the revenue effect of the shrinking tax base.

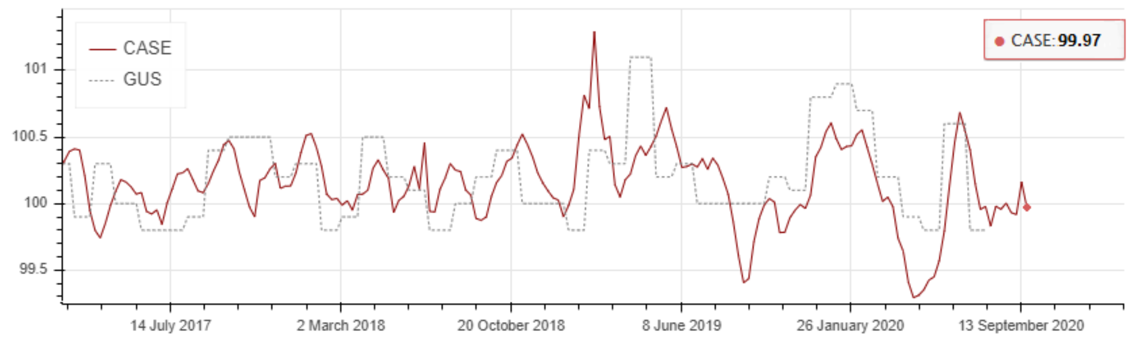
Other CASE Products

The Weekly Online CASE CPI

The online CASE CPI is an innovative measurement of price dynamics in the Polish economy, which is entirely based on online data. The index is constructed by averaging prices of commodities from the last four weeks and comparing them to average prices of the same commodities from four weeks prior. The index is updated weekly. For more information on our weekly online CASE CPI, please visit: http://case-research.eu/en/online-case-cpi.

The late-September read-out of Online CASE CPI showed that the overall price level in the Polish economy remained stable over the last weeks. The situation is reflected in the detailed read-outs for specific categories of inflation basket – the biggest observed change in average prices was recorded in "Transportation" category where prices went up by only 0.6%. Further, prices in "Education" category went up by 0.4% (which is typical for September), while prices in "Food" category fell by 0.2%.

Our Weekly Online CASE CPI



Monthly CASE Forecast for the Polish Economy

Every month, CASE experts estimate a range of variables for the Polish economy, including future growth, private consumption, investments, industrial production, growth of nominal wages, and the CPI.

CASE economic forecasts for the Polish economy
(average % change on previous calendar year, unless otherwise indicated)

	GDP	Private consumption	Gross fixed investment	Industrial production	Consumer prices	Nominal monthly wages
2020	-4.5	-4.7	-8.3	-5.0	3.0	3.2
2021	3.8	4.0	3.4	2.8	2.6	3.2

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