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Belarus Under War Sanctions

Numerous developed countries have imposed tough sanctions on Belarus, as the Belarusian regime has become part of the Russian aggression against Ukraine. At the same time, economic relations with Ukraine have been disrupted. These shocks have simultaneously disturbed the Belarusian economy and triggered a severe recession. Thanks to several positive effects from the external environment, some success from measures undertaken by the authorities to stabilize output, and some degree of resilience – all seasoned with a large portion of good luck – the situation of the Belarusian economy is however “not that bad”. Nonetheless, the Belarusian economy is experiencing its worst economic crisis since the mid-1990s, and the current path of the economy is highly unstable and associated with numerous risks and threats. In economic terms, it is likely the case that the full costs from the sanctions are yet to be paid.



Sanctions, Multiple Shocks and Their Potential Implications

As the Belarusian regime has become part of the Russian war on Ukraine many developed countries have adopted tough sanctions against Belarus. These sanctions include an embargo on a large share of Belarusian exports and imports, prohibitions and restrictions on transportation of goods of Belarusian origin, restrictions on and/or blocking actions regarding financial operations and settlements, a freeze of parts of the Belarusian international reserves, and numerous restricting and blocking actions against banks, companies and individuals. Such sanctions, combined with a new external environment, cause powerful indirect effects with foreign companies exiting the Belarusian market and refusing business with Belarusian counterparts. Additionally, some Belarusian businesses and employees have left the country. On top of this, economic relations with Ukraine, formerly Belarus's second largest trading partner, have been virtually reduced to zero.

In economic terms, the above mentioned may be treated as a bundle of simultaneous powerful shocks to the national economy, differing in direction, mechanics, size, and persistence. These shocks may be grouped into three clusters.

The first cluster covers demand shocks, and in particular export shocks. According to our assessments, the exogenous demand shock following the sanctions may reduce Belarusian exports (in physical terms) by 40 percent, compared to previous steady-state levels. This figure should however be seen as a potential lower bound which may be realized if no measures to mitigate the impact from the sanctions are undertaken. Belarusian authorities and businesses are however doing their best trying to find new buyers for the "vanishing" exports, bypass restrictions in order to connect to "old" buyers, and establish new logistic and financial chains. The extent to which these attempts may be successful depends on the global environment, the

degree of the price competitiveness of Belarusian producers, and numerous non-economic factors. Additionally, all factors affecting exports are unstable and volatile. Exports under these new conditions are therefore less sustainable and may fluctuate in an extremely wide range. Shocks to consumption and investments stemming from weakened sentiment and expectations further amplify the demand shocks.

The second cluster of shocks relates to the supply side of the economy. It includes business closures, emigration that weakens labor supply, and production bottlenecks due to the inaccessibility of imports. Supply shocks are hard to quantify, but we perceive them as persistent and cumulative. Business closures and emigration have irrevocable effects on the national economy (at least in the medium-term), and a continuation of such drop-outs will likely amplify the size of the shock.

The third cluster combines different primarily nominal shocks: price, exchange rate, financial stability and fiscal ones. Such shocks have become permanent companions to the Belarusian economy under the sanctions, and they are volatile in terms of size. As a result, the corresponding economic indicators are likely to also become highly unstable.

This bundle of adverse shocks shifts the economy down from the previous, close to steady-state, trajectory. A new trajectory is however far from predetermined. Firstly, it depends on the effectiveness of the government in curbing the shocks stemming from the sanctions, as the actual path of the economy may be considerably affected by monetary or fiscal policy and other interventions. Secondly, some positive exogenous shocks may partially offset the effects from adverse ones. Lastly, the economy, at least for a while, may resist through exploitation of accumulated buffers (such as, international reserve assets, financial reserves of State-owned enterprises that were accumulated under favorable conditions in 2021 etc.).



Considering the worst possible assumptions regarding the above mentioned issues, our model-based simulations predict a severe recession of about 20 percent (as compared to the output peak in 2021-Q2). This recession is accompanied by a sharp increase in inflation (which in turn is highly likely to be supplemented by a full-fledged financial crisis). This simulation should however be regarded as the potential rock bottom. Whether it will become reality or not critically depends on the Belarusian government's policies.

Policy Response by the Authorities

The root cause of the problem, namely the provision of Belarusian territory for the Russian army, has never been publicly discussed by Belarusian officials. Instead, the government has focused on strategies which treat the symptoms, rather than focusing on curing the disease itself. The main coping strategies that were publicly discussed include: 1) expected increase in Russian support and exports to Russia 2) re-orientation of exports towards Asian and developing markets 3) greater mobilization of domestic resources and 4) monetary, fiscal and other stimuli.

The Russia-related initiatives are often beyond convention and include some radical proposals. These are, for instance, accelerating the establishment of sea terminals in Russian ports, promoting exports to Russia, and requesting greater financial support from Russia linked to the so-called “deep integration” package (mainly in the form of energy subsidies, import substitution investments and direct subsidies). Adherence to these proposals would mean that Belarusian authorities de facto accept serving as a Russian protectorate and correspondingly take on the role of a puppet government.

Belarusian authorities have reached some success from choosing the “Russian track” as the debt payments to Russia were postponed, new cheap gas and oil prices were granted and export to Russia increased by 15 percent in the first 8 months

of 2022. The Belarusian regime’s \$7 billion compensation claim for incurred economic losses due to the war has however been rejected by Russia so far.

The coping strategy of export re-orientation serves primarily as a rhetoric intervention as China and other Asian countries considered by the government cannot fully replace the European market. For many Belarusian exports, the EU was a premium, high-margin market while re-orientation means at best lower margins. The success of re-orientation depends on the degree of price competitiveness, which can change greatly over time. The only success from this strategy to date is the re-orientation of 10 percent of potash exports to China via railroad (incurring greater transportation costs).

The third strategy “greater mobilization of domestic resources” firstly assumes more interference with the business activity of State-owned enterprises (SOE). Despite severe demand shocks these are pressured by the government to maintain production and/or salaries, the latter in order to support output via sustained consumer demand. Further, a “discipline” component of the strategy is implemented through renewed catch-pay-and-release practices. In effect, businessmen are arrested based on anti-corruption or tax fraud criminal charges. They are then offered to pay certain amounts to the state and released if they choose to pay.

Since late spring, when direct financial shocks have been suppressed, the authorities have intensified stimulus measures to the economy. In the fiscal sphere, these are aimed at promoting exports and mainly provided on an individual or sectoral basis. To a large extent, these stimuli may be seen as partial compensation to SOEs for their output-supporting role. In the monetary sphere a specific environment in which the Russian ruble is appreciated vs. the US dollar, despite the worldwide strength of the latter, has allowed the authorities to implement a “magic” (but highly likely temporary) solution: The Belarusian national currency is manipulated to depreciate vs.



the Russian ruble (both in nominal and real terms) but appreciate vs. the US dollar. The former leads to a great increase in price competitiveness (as Russia is today the dominant trading partner), while the latter serves as a buffer for fragile prices and provides financial stability. Moreover, the authorities have excessively softened monetary policy, trying to spur domestic credit. These measures lead to heightened inflation pressure, which is however somehow suppressed by reinvigorated direct price controls.

Current Situation and Future Implications

Until now, the Belarusian economy places far from the potential rock bottom. By the end of the second quarter in 2022, output losses (vs. the output peak in 2021-Q2) amounted to about 5.5 percent. By the end of 2022, they are however expected to increase to about 8.5 percent (vs. the 2021-Q2 output peak). The Belarusian economy is stuck in a heightened inflation environment – with the inflation being as high as 20 percent in annual terms. Although the inflation is considerably higher than in “normal times”, it is still not a disaster (considering the much higher projected level under the worst-case scenario and the background of 40-year peak in global inflation). Moreover, the current situation is still far from a full-fledged financial crisis, despite some financial turbulence.

The position of the economy as “not that bad”, is a result of existing buffers, positive effects from the external environment and some immediate efficiency from actions undertaken by the authorities to stabilize output – all seasoned with a large portion of good luck. For instance, the jump in price competitiveness accounts for a large share of curbing efforts that counter the sanctions. This is, in turn, due to a combination of high global

prices, low and frozen energy prices for Belarus, and a very specific and unstable stance on monetary policy underpinned by direct price controls. Some buffer savings that Belarusian SOEs succeeded to accumulate during the period of the so-called “foreign trade miracle” in late 2020 and 2021 also play an important role. Last but not least, the Belarusian authorities seem to have succeeded in the partial curbing of the export shock. Since the beginning of summer, there are some signs of recovery in exports which most likely reflects a partial recovery of exports within the most sensitive domains: oil products and potash fertilizers (corresponding statistics have been blocked out).

However, the “not that bad” position of the economy does not mean good. According to all standard metrics, Belarus is currently experiencing a severe economic crisis. The notion that it could be even more severe is bad news, not good ones. Moreover, the current situation is extremely unstable and fragile. The economy is facing numerous distortions, contradictions and risks, all of which can still shift the scenario of the crisis from the “not that bad” situation to the worst possible.

Conclusion

The Belarusian regime’s involvement in the Russian aggression against Ukraine have propelled Belarus into the most severe economic crisis since the mid-1990s. Until recently, fortunate external economic circumstances, a specific policy mix and a good portion of luck have allowed for a partial mitigation of the crisis. The situation is however extremely unstable and the full effects from the sanctions are likely yet to be realized.





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