

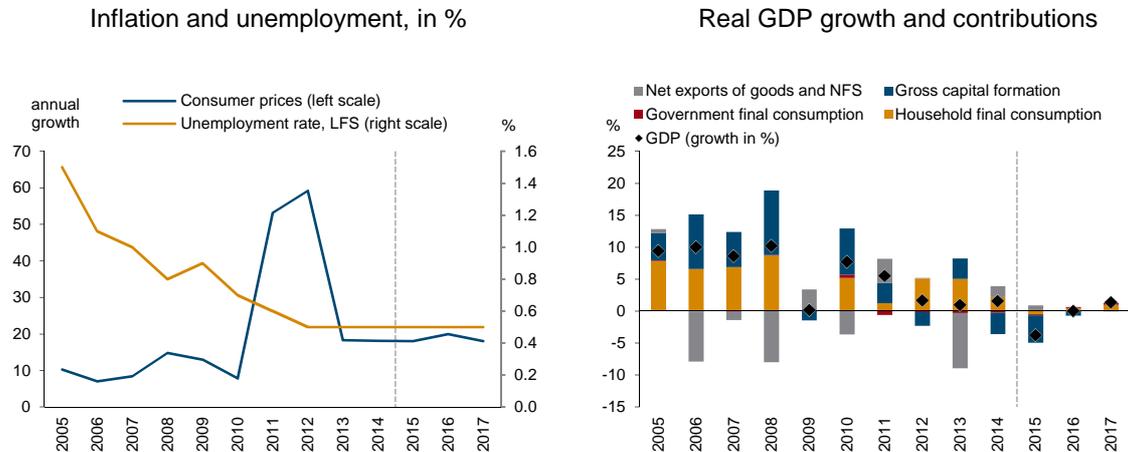


BELARUS: Economy sinks further down

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Belarus has gone into recession for the first time in more than 15 years as a result of a combination of external shocks and chronic macroeconomic distortions. Further policy adjustments aimed at reducing macroeconomic disequilibria are likely after the October presidential elections. The short- and medium-term prospects remain gloomy; they will depend largely on the eventual recovery of the Russian economy. In all probability, Belarus will only return to a growth scenario in 2017.

Figure 40 / Belarus: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The economy of Belarus has kept losing steam in the course of 2015, slipping further into recession. Following a drop by 2.3% in the first quarter of 2015, GDP registered a further 4.5% year-on-year decline in the second quarter, resulting in a 3.5% year-on-year drop in the first half. The continuing recession in Russia – Belarus' main export market – contributed to the further slump in Belarus' economic activity. Similarly, the deepening economic turmoil in Ukraine, another key export market for Belarus, added to the depth of the external shock. Exports, and hence the manufacturing industry, suffered the most from the contraction in export demand. In the first half of 2015, Belarus' total trade turnover fell by a quarter compared to the same period of 2014 while real industrial output dropped by 7.4%.

On the demand side, apart from exports, gross fixed capital formation also took a serious hit and its contraction deepened: a drop by 3.1% in the first quarter was followed by a much more pronounced (by 23.1%) fall in the second quarter, resulting in an average decline by 14.2% in the first half of 2015. Private consumption was not so affected but still registered a small drop in this period. At the same time, there was a slight upturn in real retail trade in 2015. One of the factors supporting retail sales was probably the introduction of wide-ranging price controls on a number of consumer goods which likely contributed to distortions and shifts in the structure of prices, making some goods more attractive. Some precautionary purchases were probably also taking place in the anticipation of future price increases.

As suggested by anecdotal evidence, the economic downturn in Belarus hit harshly the labour market as well, producing massive layoffs. However, in the absence of reliable LFS statistics, the official statistics on employment and registered unemployment fails to reflect the magnitude of this shock.

Flash estimates of economic activity in July and August suggest that aggregate economic output and real industrial output continued to shrink and there are no clear signals yet that the economy is on the way to bottom out.

The recession in Belarus has been accompanied by dynamic changes in the macroeconomic sphere as well as by an activist macroeconomic policy stance. The government announced early on its willingness to prevent inflationary spillovers from the exchange rate crisis and took a range of policy measures – both fiscal and monetary – to this effect. On the fiscal side this amounted to a considerable tightening of the fiscal stance, sometimes involving very rigid controls and even cuts in public expenditure.

In 2015 there was also a radical shift in the policy instruments used by the monetary authorities: while before the recent currency crisis they mainly used exchange rate targeting as a key policy instrument, at the beginning of the year this was abandoned and the Belarusian National Bank turned to targeting the money supply. In line with this policy course, the National Bank raised in August the reserve requirements for commercial banks. The exchange rate remains as an indicative target based on a basket of three currencies: the US dollar, the euro and the Russian rouble.

However, what is peculiar in the case of Belarus is that the quantitative management of the money supply is mostly effectuated through direct controls on money creation, including by setting caps on the refinancing of commercial banks and reducing the direct channelling of public funds through the banking system. These channels of directed credit were both sources of inflationary pressure and of implicit subsidies to ailing SOEs. Hence such a monetary tightening, if sustained, may contribute to the start of a process of restructuring of the outdated industry. On the other hand, it adds to the woes of the big industry which suffered losses in export markets.

These macroeconomic policy efforts have been coupled with administrative controls on the retail prices of a number of consumer goods. The price controls were announced as temporary and subsequently the government started removing some of them.

Up to now this set of measures has managed to put some brakes on the price dynamics. Notably, the rate of inflation in 2015 has been lagging considerably behind the pace of depreciation: thus, while the index of the basket of currencies increased by some 27% between December 2014 and August 2015, CPI in the same period grew by 11.8%. Weakening domestic demand also contributed to the relatively modest inflation.

At the same time, the abortion of massive direct interventions on the foreign exchange market in 2015 highlighted even more the very high dependence of Belarus on the Russian economy and the strength of contagion effects: in the absence of such interventions, volatility in the Russian foreign exchange market is directly transmitted to the Belarusian currency markets with the Belarusian rouble also following closely the fluctuations of the Russian rouble.

The loss of export revenue has put even more strain on the balance of payments. In the past several years, Belarus has been facing chronic balance of payments constraints. Rather than adopting corrective policy measures towards a more stable macroeconomic equilibrium, policy efforts have been mostly directed towards attracting additional external financial resources to mitigate the effect of the balance of payments constraints. In the same vein, considerable efforts are made in 2015 to mobilise additional foreign borrowing in support of the balance of payments, mostly for the repayment of maturing old debt.

Russia has been a main source of such lending. In July, the Russian government extended a USD 760 million loan to the Belarusian government as balance of payments support. Russia also pledged to restructure USD 1.3 billion of past loans to Belarus maturing in 2015. On top of that, the Russian Sberbank extended a USD 500 million commercial loan to the Belarusian industrial giant Belaruskalii, one of the largest producers of potassium fertilisers in the world. Belarus also officially requested in March up to USD 3 billion loans from the Stabilisation and Development Fund of the Eurasian Development Bank. In the course of the year, the Eurasian Development Bank has been discussing with the Belarusian authorities the framework conditions of such a loan and while a final deal has not been sealed yet, Belarus is expected to receive a first tranche by the end of the year.

Belarus also started negotiations with the IMF for a new balance of payments support loan. The IMF has voiced its readiness to negotiate such funding on the basis of a medium-term reform programme jointly agreed with the World Bank. Preparatory work on such a programme has started but there is no public information on progress in this area.

Overall it appears that the authorities have been able to prevent a balance of payments crisis in 2015. However, apart from cementing in-built macroeconomic distortions, the current policy course has led to a fast accumulation of considerable external debt. While still remaining in a manageable range, the mounting debt indicates that the policy of the past is no longer sustainable. The authorities were aiming to prevent any macroeconomic destabilisation in the run-up to the presidential elections held in October; however, after the elections, one can expect more significant changes in the policy course.

The short-term prospects for the Belarusian economy continued to deteriorate in the course of the year. The recession has deepened and GDP is expected to drop by some 3-4% for the year 2015 as a whole. The chances for a recovery largely hinge on the prospects of the Russian economy which are not rosy anyway. It can be expected that the authorities will continue to maintain a tighter than usual macroeconomic stance with the ambition to prevent an inflationary outburst. However, given the significant depreciation of the exchange rate, an upward adjustment in the level of prices seems unavoidable, if not in 2015 then in the following years. The 2016 forecast is based on the assumption of a gradual modest recovery in exports and may therefore be on the high side. Coupled with a similarly modest growth in private consumption this could contribute to arresting the economic decline but will hardly leave scope for a substantial recovery. A modest upturn, even in this optimistic scenario, is only expected in 2017.

Table 7 / Belarus: Selected economic indicators

| | 2011 | 2012 | 2013 | 2014 ¹⁾ | 2014 | 2015 | 2015 | 2016 | 2017 |
|---|---------|---------|---------|--------------------|--------------|---------|----------|-----------|-----------|
| | | | | | January-June | | Forecast | | |
| Population, th pers., average ²⁾ | 9,473 | 9,465 | 9,466 | 9,475 | . | . | 9,490 | 9,510 | 9,530 |
| Gross domestic product, BYR bn, nom. | 297,158 | 530,356 | 649,111 | 778,456 | 345,111 | 399,109 | 883,700 | 1,060,400 | 1,268,800 |
| annual change in % (real) | 5.5 | 1.7 | 1.0 | 1.6 | 1.3 | -3.5 | -3.8 | 0.0 | 1.4 |
| GDP/capita (EUR at exchange rate) | 3,900 | 5,200 | 5,800 | 6,200 | . | . | 5,200 | 5,100 | 5,500 |
| GDP/capita (EUR at PPP) | 12,500 | 13,100 | 13,300 | 13,700 | . | . | . | . | . |
| Consumption of households, BYR bn, nom. | 139,955 | 244,863 | 318,332 | 393,956 | 177,527 | 202,254 | . | . | . |
| annual change in % (real) | 2.3 | 10.8 | 10.9 | 4.5 | 5.6 | -1.8 | -1.0 | 1.0 | 2.0 |
| Gross fixed capital form., BYR bn, nom. | 113,230 | 178,455 | 244,296 | 249,623 | 105,532 | 105,977 | . | . | . |
| annual change in % (real) | 13.9 | -11.3 | 9.6 | -8.9 | -7.4 | -14.2 | -12.0 | -2.0 | 0.0 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 9.1 | 5.8 | -4.9 | 2.0 | -1.1 | -7.4 | -6.0 | 0.0 | 3.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 6.6 | 6.6 | -4.2 | 2.9 | -4.3 | 2.7 | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | 6.7 | -8.6 | 4.6 | -5.7 | . | . | . | . | . |
| Reg. employment, th, average | 4,691 | 4,612 | 4,578 | 4,551 | 4,561 | 4,495 | 4,470 | 4,450 | 4,430 |
| annual change in % | -0.3 | -1.7 | -0.7 | -0.6 | -0.7 | -1.4 | -1.8 | -0.4 | -0.4 |
| Reg. unemployment rate, in %, end of period | 0.6 | 0.5 | 0.5 | 0.5 | 0.5 | 1.0 | 0.5 | 0.5 | 0.5 |
| Average monthly gross wages, ths BYR | 1,900 | 3,676 | 5,061 | 6,052 | 5,763 | 6,457 | 7,000 | 8,400 | 10,000 |
| annual change in % (real, gross) | 1.9 | 21.5 | 16.4 | 1.3 | 3.2 | -2.9 | -2.0 | 0.0 | 1.0 |
| Consumer prices, % p.a. | 53.2 | 59.2 | 18.3 | 18.1 | 17.1 | 15.3 | 18.0 | 20.0 | 18.0 |
| Producer prices in industry, % p.a. ³⁾ | 71.4 | 76.0 | 13.6 | 12.8 | 11.3 | 17.7 | 20.0 | 20.0 | 18.0 |
| General governm.budget, nat. def., % of GDP ⁴⁾ | | | | | | | | | |
| Revenues | 38.7 | 38.5 | 40.3 | 38.6 | 40.6 | 43.2 | 41.0 | 40.0 | 39.0 |
| Expenditures | 35.9 | 37.7 | 40.1 | 37.3 | 40.5 | 39.3 | 39.0 | 39.0 | 38.0 |
| Net lending (+) / net borrowing (-) | 2.8 | 0.8 | 0.2 | 1.3 | 0.1 | 3.9 | 2.0 | 1.0 | 1.0 |
| Public debt, EU-def., % of GDP | 45.9 | 38.5 | 37.6 | 39.8 | . | . | 40.0 | 39.0 | 39.0 |
| Central bank policy rate, % p.a., end of period ⁵⁾ | 45.0 | 30.0 | 23.5 | 20.0 | 21.5 | 25.0 | 25.0 | 24.0 | 22.0 |
| Current account, EUR mn ⁶⁾ | -3,518 | -1,446 | -5,737 | -4,034 | -1,840 | -467 | -1,200 | -1,500 | -1,800 |
| Current account, % of GDP ⁶⁾ | -9.5 | -2.9 | -10.5 | -6.9 | -7.1 | -1.9 | -2.4 | -3.1 | -3.4 |
| Exports of goods, BOP, EUR mn ⁶⁾ | 28,499 | 35,391 | 27,701 | 27,492 | 13,637 | 12,115 | 26,800 | 27,400 | 28,000 |
| annual change in % | 55.6 | 24.2 | -21.7 | -0.8 | -4.5 | -11.2 | -2.5 | 2.2 | 2.2 |
| Imports of goods, BOP, EUR mn ⁶⁾ | 30,913 | 34,952 | 31,183 | 29,537 | 13,870 | 12,131 | 28,500 | 29,000 | 29,500 |
| annual change in % | 22.4 | 13.1 | -10.8 | -5.3 | -9.1 | -12.5 | -3.5 | 1.8 | 1.7 |
| Exports of services, BOP, EUR mn ⁶⁾ | 3,906 | 4,901 | 5,690 | 6,113 | 2,797 | 2,869 | 5,800 | 5,900 | 6,000 |
| annual change in % | 9.0 | 25.5 | 16.1 | 7.4 | 3.7 | 2.6 | -5.1 | 1.7 | 1.7 |
| Imports of services, BOP, EUR mn ⁶⁾ | 2,334 | 3,140 | 3,983 | 4,424 | 2,111 | 1,812 | 4,100 | 4,200 | 4,300 |
| annual change in % | 3.9 | 34.5 | 26.8 | 11.1 | 18.9 | -14.2 | -7.3 | 2.4 | 2.4 |
| FDI liabilities (inflow), EUR mn ⁶⁾ | 2,787 | 1,137 | 1,703 | 1,445 | 983 | 1,198 | 1,400 | . | . |
| FDI assets (outflow), EUR mn ⁶⁾ | 87 | 121 | 199 | 57 | 16 | 70 | 100 | . | . |
| Gross reserves of NB, excl. gold, EUR mn | 4,648 | 4,390 | 3,589 | 2,820 | 3,432 | 3,254 | . | . | . |
| Gross external debt, EUR mn ⁶⁾ | 26,305 | 25,518 | 28,807 | 32,982 | 29,962 | 41,959 | 42,700 | 43,400 | 43,900 |
| Gross external debt, % of GDP ⁶⁾ | 71.3 | 51.9 | 52.5 | 56.0 | 50.9 | 85.5 | 87.0 | 90.0 | 83.0 |
| Average exchange rate BYR/EUR | 8,051 | 10,778 | 11,834 | 13,220 | 13,296 | 16,474 | 18,000 | 22,000 | 24,000 |
| Purchasing power parity BYR/EUR | 2,504 | 4,283 | 5,145 | 5,985 | . | . | . | . | . |

1) Preliminary. - 2) According to census October 2009. - 3) Domestic output prices. - 4) Quarterly data refer to first estimates on a monthly basis. - 5) Refinancing rate of NB. - 6) Converted from USD and based on BOP 6th edition.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.