

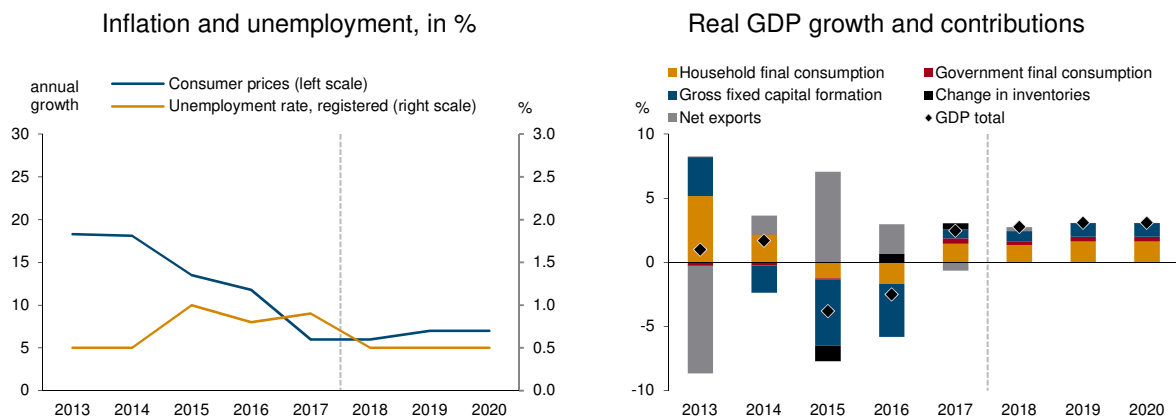


BELARUS: Improving external environment supports modest growth

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GDP in Belarus grew by 2.4%, defying the expectations of a continuing recession. Thanks to an improvement in the external environment, manufacturing output and exports rebounded strongly. Tighter macroeconomic policies contributed to a shrinking of the current account deficit and a lowering of inflation expectations. Inflation reached a historic low in 2017. The short-term prospects have improved and positive economic growth should continue in the coming years.

Figure 41 / Belarus: Main macroeconomic indicators



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

In 2017, GDP in Belarus grew by 2.4%, defying the prevailing ex ante expectations of a continuing recession. It was the improving external environment that contributed to this positive outcome. Settlement of the gas dispute with Russia paved the way for the resumption of normal deliveries of oil from Russia and of funding under the existing agreement with the Eurasian Development Bank. Rising oil prices contributed to an improvement in Belarus's terms of trade and higher fiscal revenue.

However, the unreformed economy lacks dynamism and, in the absence of restructuring, its potential for more robust growth in the future is limited. During the prolonged and deep recession of 2015-2016, Belarusian GDP plunged by a cumulative 5.5%. Thus, although the economic upturn in 2017 was a welcome outcome, real GDP in 2017 was still below its 2014 level. Nevertheless, recent data indicate that the recovery has been gaining momentum and is likely to continue in the immediate future.

Thanks to an improvement in external conditions and the presence of underutilised capacity, manufacturing rebounded strongly in 2017, with annual gross output growing by 7%; meanwhile the export of goods in dollar terms surged by more than 20% compared to 2016. However, the recovery was uneven across manufacturing sectors, and much of the overall output growth was due to a strong performance in a few branches, such as wood processing, mechanical engineering and chemicals. At the same time, the recession continued and deepened in the sector of transport equipment.

The output recovery did not bring about growth in employment, as the Belarusian economy is undergoing a lasting – but slow – process of restructuring, which involves steadily picking up the slack in large state-owned enterprises (SOEs).

The upturn in output contributed to a gradual recovery of domestic demand (both personal consumption and fixed investment), which became especially pronounced in the second half of the year. The real disposable income of the population increased by an estimated 1.5% after two consecutive years of decline. Real retail trade in 2017 grew by 2.8% year on year, and the positive growth was entirely due to the upturn in the second half. Gross fixed capital formation surged sharply in the third quarter, after a weak performance in the first half year. Overall, domestic demand made a positive contribution to GDP growth, after contributing negatively in 2015-2016.

Importantly, the recovery was accompanied by notable progress towards macroeconomic stability. Average annual inflation grew by 6% in 2017 (4.6% December over December) – a historic low for Belarus. The curbing of inflation was the result of a change in the macroeconomic policy mix in 2015, which combined tight monetary and fiscal policy with a steady reduction in directed credit. Reflecting the reduction in inflation expectations, the National Bank of Belarus reduced its key intervention rate in several stages from 18% at end-2016 to 10.5% in February 2018. The nominal exchange rate (which has floated since 2015) remained relatively stable vis-à-vis the USD through the year, which was another sign of increasing macroeconomic stability.

It is estimated that regulated prices in 2017 grew 1.8 times faster than unregulated prices. This indicates that under the present circumstances, the mechanism of price regulation (which still covers a significant basket of goods and services) has been operating in a pro-inflationary rather than an anti-inflationary way.

The level of ‘directed credit’ (subsidised credit allocated to state-owned firms participating in government programmes) has been on the decline in recent years. According to a government decision, such credit should be reduced in 2018 by a third, compared to 2017. However, there is still a large pool of loss-making SOEs that are being supported through directed credit, which then turns into bad debt. Over the period 2015-2016, the government restructured bad enterprise debt worth a total of USD 1.8 billion, which was transferred to the newly established Agency for Asset Management.

However, unless the flow of newly generated bad loans is stopped, loss-making SOEs will continue to accumulate new stocks of bad debt, as is evident from the dynamics of non-performing loans.

Tighter macroeconomic policies have contributed to a gradual shrinking of the current account deficit, which at present seems to be at manageable levels. In 2017, Belarus managed to raise significant external funding, which allowed comfortable servicing of its external debt. The authorities secured new borrowing totalling USD 4.04 billion, including three tranches worth a total USD 0.8 billion from the current funding agreement with the Eurasian Development Bank (following USD 0.8 billion received in 2016); USD 1.3 billion from the Russian government and Russian banks; USD 306 million from Chinese banks; and a Eurobond issue worth USD 1.4 billion, which was successfully placed in June. As total debt servicing in 2017 amounted to USD 1.03 billion, these moves allowed Belarus to raise its international reserves.

So far Belarus has been a conscientious borrower on the international financial markets. In January 2018, it made the last coupon payment and retired its 2011 Eurobond issue, worth USD 800 million. Also in January 2018, Fitch Ratings upgraded Belarus's long-term default ratings from 'B-' to 'B' with a 'Stable' outlook. At the same time, the servicing of the swelling public external debt remains a serious and growing burden both on Belarus's public finances and on its balance of payments. Over the course of 2017, public external debt increased by 22.6%, to USD 16.7 billion at end-December, and in 2018 Belarus faces upcoming debt service payments totalling USD 2.54 billion. The opportunity cost of this burden is the underfinancing of public services and investment, which, in the long run, reduces the potential for future growth.

One important policy document adopted in 2017 was the Presidential Decree No. 7 on entrepreneurship. It contains a number of regulatory changes aimed at further liberalisation of entrepreneurial activity, in the first place, by reducing administrative controls and hurdles for SMEs and individual entrepreneurs (such as scrapping the previous need to obtain permission for a range of business activities). Another related policy step was the liberalisation as of 1 March 2018 of forex purchases by Belarusian importers (proof of purpose is no longer required). These changes have been welcomed by the business community, but it remains to be seen how they are implemented in reality.

Higher oil prices in 2017 provided an estimated extra budgetary revenue of BYN 1.1 billion (EUR 0.5 billion), which, in turn, contributed to a surplus in the cash fiscal balance for the year. Subsequently, most of this surplus was channelled to the Social Security Fund to boost pensions and other allowances, thus contributing to the rise in real disposable income. Should oil prices continue to rise in 2018, one can expect a similar windfall gain in Belarus's public finances.

In general, the short-term prospects for the Belarusian economy have improved, and positive economic growth should continue in the coming two to three years. Oil deliveries from Russia in 2018 should reach the annual level of 24 million tonnes, as per the bilateral mid-term agreement – a level that was not attained in 2017, as the dispute between the two countries was only settled in April (it is estimated that deliveries in 2017 amounted to some 18 million tonnes). This should provide the Belarusian economy with a further external boost compared to 2017. The Belarusian government is targeting GDP growth of 3.5% in 2018, and annual inflation (December over December) of no more than 6%.

This may be a somewhat ambitious target: wiiw expects that GDP will grow by 2.8% in 2018. We envisage that growth will be predominantly driven by domestic demand – private consumption and fixed investment, both of which should continue their moderate recovery. If the recovery in Russia strengthens, this could support a further upturn in Belarus's exports. However, with the recovery in domestic demand, import growth may also pick up and the current account deficit may widen; that said, it should remain at a reasonable level. Overall we expect a negligible contribution of net exports to GDP growth.

If the authorities retain macroeconomic stability as a policy priority, the potential for a notable acceleration of growth in the future seems limited. The tight policy stance, the curbing of directed credit and the ongoing restructuring in the labour market would likely keep GDP rates of growth in the range of 3% p.a. in the coming years.

Table 11 / Belarus: Selected economic indicators

	2013	2014	2015	2016	2017 ¹⁾	2018	2019	2020
						Forecast		
Population, th pers., average	9,466	9,475	9,490	9,502	9,498	9,530	9,550	9,560
Gross domestic product, BYN mn, nom. ²⁾	67,069	80,579	89,910	94,949	105,200	114,600	126,400	139,400
annual change in % (real)	1.0	1.7	-3.8	-2.5	2.4	2.8	3.1	3.1
GDP/capita (EUR at PPP) ²⁾	13,400	13,900	13,900	13,400	13,800	.	.	.
Consumption of households, BYN mn, nom. ²⁾	33,970	42,082	47,006	51,122	58,700	.	.	.
annual change in % (real)	10.9	4.3	-2.4	-3.2	2.7	2.5	3.0	3.0
Gross fixed capital form., BYN mn, nom. ²⁾	24,941	26,772	25,763	24,155	27,760	.	.	.
annual change in % (real)	9.0	-5.7	-15.5	-14.5	2.8	3.0	4.0	4.0
Gross industrial production								
annual change in % (real)	-4.9	1.9	-6.6	-0.4	6.1	4.0	4.0	4.0
Gross agricultural production								
annual change in % (real)	-4.0	3.1	-2.5	3.3	4.1	.	.	.
Construction industry								
annual change in % (real)	4.7	-5.7	-11.3	-14.8	-3.8	.	.	.
Reg. employment, th, average	4,578	4,551	4,496	4,406	4,352	4,330	4,310	4,290
annual change in %	-0.7	-0.6	-1.2	-2.0	-1.2	-0.5	-0.5	-0.5
Reg. unemployed persons, th, eop	21.0	24.2	43.3	35.3	22.9	22.0	22.0	22.0
Reg. unemployment rate, in %, eop	0.5	0.5	1.0	0.8	0.5	0.5	0.5	0.5
Average monthly gross wages, BYN	506.1	605.2	671.5	722.7	815.2	880	960	1,040
annual change in % (real, gross)	16.4	1.3	-2.3	-3.8	6.2	1.5	1.5	1.5
Consumer prices, % p.a.	18.3	18.1	13.5	11.8	6.0	6.0	7.0	7.0
Producer prices in industry, % p.a. ³⁾	13.7	12.4	17.2	12.0	9.8	9.0	8.0	8.0
General governm.budget, nat. def., % of GDP								
Revenues	39.0	37.3	41.3	40.9	40.0	39.0	39.0	39.0
Expenditures	38.8	36.1	39.9	39.4	39.0	38.0	38.0	38.0
Deficit (-) / surplus (+)	0.2	1.3	1.4	1.5	1.0	1.0	1.0	1.0
General gov.gross debt, nat. def., % of GDP ⁴⁾	34.5	38.0	53.0	53.9	48.0	47.0	46.0	45.0
Stock of loans of non-fin.private sector, % p.a.	28.8	21.1	19.4	-6.2	7.2	.	.	.
Non-performing loans (NPL), in %, eop	4.4	4.4	6.8	12.8	13.5	.	.	.
Central bank policy rate, % p.a., eop ⁵⁾	23.5	20.0	25.0	18.0	11.0	9.0	8.0	7.0
Current account, EUR mn ⁶⁾	-5,737	-4,057	-1,669	-1,523	-1,100	-1,500	-1,500	-1,600
Current account, % of GDP ⁶⁾	-10.1	-6.7	-3.3	-3.5	-2.3	-3.4	-3.3	-3.4
Exports of goods, BOP, EUR mn ⁶⁾	27,701	27,492	23,854	20,988	25,400	25,000	26,700	29,200
annual change in %	-21.7	-0.8	-13.2	-12.0	21.0	-1.6	6.8	9.4
Imports of goods, BOP, EUR mn ⁶⁾	31,183	29,537	25,807	23,270	28,000	26,700	28,300	30,800
annual change in %	-10.8	-5.3	-12.6	-9.8	20.3	-4.6	6.0	8.8
Exports of services, BOP, EUR mn ⁶⁾	5,690	6,115	6,048	6,194	6,900	6,800	7,000	7,200
annual change in %	16.1	7.5	-1.1	2.4	11.4	-1.4	2.9	2.9
Imports of services, BOP, EUR mn ⁶⁾	3,983	4,449	4,003	3,983	4,200	4,300	4,500	4,800
annual change in %	26.8	11.7	-10.0	-0.5	5.4	2.4	4.7	6.7
FDI liabilities, EUR mn ⁶⁾	1,703	1,445	1,506	1,133	1,100	.	.	.
FDI assets, EUR mn ⁶⁾	199	57	97	112	100	.	.	.
Gross reserves of NB excl. gold, EUR mn ⁶⁾	3,589	2,820	2,510	3,071	4,502	.	.	.
Gross external debt, EUR mn ⁶⁾	28,807	32,982	34,996	35,930	35,200	30,900	30,700	30,700
Gross external debt, % of GDP ⁶⁾	50.8	54.1	69.4	83.3	73.1	70.0	68.0	66.0
Average exchange rate BYN/EUR	1.1834	1.3220	1.7828	2.2010	2.1833	2.6	2.8	3.0

1) Preliminary and wiiw estimates. - 2) According to SNA 2008. - 3) Domestic output prices. - 4) Including publicly guaranteed debt. - 5) Refinancing rate of NB. - 6) Converted from USD.

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