

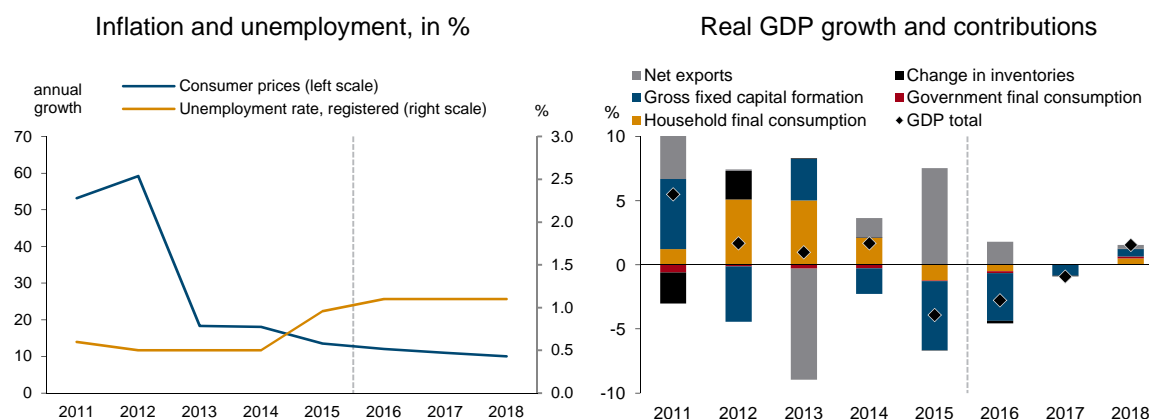


## BELARUS: No end to the recession in sight

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The recession in Belarus has continued for the second year running. GDP dropped by 2.5% in the first half of 2016. Balance of payments constraints have compelled Belarus to pursue macroeconomic austerity policies, which dampened economic activity. The country's problems have been compounded by a dispute with Russia over gas prices. GDP growth in 2016 as a whole will be negative and the recession will most likely continue into 2017.

**Figure 24 / Belarus: Main macroeconomic indicators**



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

The recession in Belarus is still in full swing for a second consecutive year. GDP fell by 2.5% in the first half of 2016 and while the aggregate output decline was decelerating in the first six months, it started accelerating again in July-August. Industrial output (industry being the backbone of the Belarusian economy) followed a similar dynamic: while in year-on-year terms monthly industrial output turned the corner in April-May, it switched back into the red in the months that followed.

The causes for the continuing recession in Belarus are numerous and involve both external and domestic factors; structural as well as cyclical elements. Regarding the external environment, the main negative factor is the continuing slump in the Russian economy – Belarus' main market – which translates into further reduction in the demand for exports from Belarus. In 2016, this was aggravated by an ongoing dispute between the two countries on the price of gas. The actual price for gas delivered from Russia is still unsettled, each side sticking to its understanding of how the agreed price mechanism

translates into a price level (the latter is higher according to Russia and lower according to Belarus). Meanwhile Russia treats the implied price difference vis-à-vis the price it has set but which was not paid by the other side as unpaid Belarusian debt and insists on the settlement of this debt.

In 2016, Russia started applying oil deliveries as a lever in an attempt to press Belarus to pay these accumulating liabilities and reduced oil supplies. Russia is virtually the only external supplier of oil for Belarus and the Belarusian economy (especially the manufacturing industry) is extremely dependent on this supply. According to Belarusian estimates, the delivery shortage for 2016 as a whole may amount to 5 million tonnes (18 million instead of the 23 million initially planned). The undersupply of resources hurts the Belarusian oil processing and chemical industries and impacts negatively on Belarusian exports. In the first half of 2016 total Belarusian exports of goods dropped by some 12% year-on-year in current euro terms after the 11% year-on-year drop experienced in the first half of 2015.

On top of that, Belarus is facing balance of payments constraints due to the large service of the external debt and the inability to raise sufficient new external finance. Hence, it has been pursuing policies of macroeconomic austerity, mainly by tightening the fiscal stance and incomes policies. This has contributed to the curbing of domestic demand (in the first place public investment but also private consumption), with negative implications for output. Thus the Belarusian economy at present is facing both an external and a domestic squeeze.

Confronted with uncertain future prospects, firms have also been downsizing their investment programmes. Access to credit is difficult as banks are burdened with a growing pile of substandard and non-performing loans while the government has scaled down directed credit. As a result, gross fixed capital formation is shrinking at double-digit rates for a second year in a row.

On the other hand, macroeconomic austerity and the ensuing suppression of private consumption contributed to the stabilisation of the exchange rate and the lowering of inflationary pressure. Belarus now adheres to a floating exchange rate regime (with the US dollar as the reference currency) under monetary targeting and despite the lack of direct controls, the nominal exchange rate vis-à-vis the dollar has basically been flat during the past several months.

Belarus' central bank has been sticking to its tight monetary targets which also contributes to the harsh macroeconomic environment. Many commercial banks experience liquidity problems due to a maturity mismatch in their balance sheets: large outstanding long-term credits (including those extended under directed lending) on the asset side and prevailing short-term deposits on the liability side. Additionally, many banks are burdened with non-performing loans which further aggravates their liquidity problems. In an attempt to address some of the problems in the banking sector, the government established in July 2016 an Agency for Asset Management which is due to take over non-performing loans from commercial banks, in the first place those extended to agricultural firms.

On 1 July Belarus implemented a currency redenomination crossing out four zeros of the Belarusian rouble. The operation was technically well prepared and went ahead smoothly. So far there have been no visible effects of this operation on daily life or the price dynamics. Inflation notably slowed down its pace and now seems to be approaching the desirable single-digit level.

In the absence of LFS-based statistics, it is difficult to assess the full effect of the recession on the Belarusian labour market. Initially, there was a moderate surge in the number of registered unemployed but starting in May this trend was reversed. However, the statistics on employment in the current year indicate a drop of some 2% in the number of employed compared to 2015.

The foreign debt remains a heavy burden on the Belarusian economy. In the first half of 2016, Belarus allocated USD 2.97 billion to foreign debt service, of which USD 2.25 billion were apportioned to the repayment of maturing debt and USD 716 million were disbursed for interest payments. Given the recessionary environment and the fall in foreign exchange revenue due to shrinking exports, debt service is impossible without new external borrowing. The main such source in 2016 was the Eurasian Fund for Stabilisation and Development (EFSD – an instrument of the Eurasian Development Bank). In March 2016, Belarus struck a deal with EFSD on a USD 2 billion loan which is due to be disbursed in 7 tranches over the period 2016-2018. Belarus already received two tranches totalling USD 800 million, and a third tranche worth USD 300 million is expected until the end of 2016.

Since 2015, Belarus has been conducting negotiations with the IMF for a new IMF-funded programme. However, the two sides have not been able to agree on the terms of this programme so negotiations are still ongoing and their outcome is uncertain. Belarus has also announced its intention for a Eurobond emission worth USD 800 million but the issue date has been postponed several times. The next target date is in 2017.

While there have been major shifts in macroeconomic policy after the currency crisis of 2014-2015 equivalent to a significant tightening of the policy stance, Belarus is still far from a point of a stable macroeconomic equilibrium. One chronic source of instability is the lack of hard budget constraints on the operations of state-owned firms and banks. In these circumstances the state-owned sector continues to generate a quasi-fiscal deficit which keeps accumulating, thus undermining the foundations of public finances and, ultimately, the declared objectives and efforts of macroeconomic policy. However, addressing the issue of soft budget constraints would entail restructuring of the state-owned sector of the economy, including the shedding of redundant labour. It remains to be seen whether the Belarusian authorities would be prepared to take radical steps in these directions.

In these circumstances no end to the recession is in sight in the short term. The authorities are likely to go on pursuing tight monetary, fiscal and incomes policies in the foreseeable future and these will continue to curb domestic demand. The external environment remains uncertain due to both the weakness of the Russian economy and the unsettled gas dispute with Russia. The foreign debt service and the ensuing balance of payments constraints further reduce the room for manoeuvre of policy-makers. Therefore, the rate of GDP growth is bound to be negative for 2016 as a whole and most likely will stay in negative territory in 2017. On the other hand, macroeconomic austerity supports the process of disinflation and the curbing of inflation expectations; this process can be expected to continue in the years ahead. So far the Belarusian authorities have managed to escape a full-blown foreign debt crisis and there are no signs that such a crisis is imminent. However, the macroeconomic situation is still fragile and will need further policy stabilisation efforts, especially through the restructuring of the state-owned part of the economy.

Table 7 / Belarus: Selected economic indicators

	2012	2013	2014	2015 <sup>1)</sup>	2015 January-June	2016	2016 Forecast	2017 Forecast	2018
Population, th pers., average	9,465	9,466	9,475	9,490	.	.	9,510	9,530	9,550
Gross domestic product, BYN mn, nom. <sup>2)</sup>	53,036	64,911	77,809	86,970	39,911	43,737	94,700	104,200	116,500
annual change in % (real) <sup>2)</sup>	1.7	1.0	1.7	-3.9	-3.4	-2.5	-2.8	-0.9	1.6
GDP/capita (EUR at exchange rate)	5,200	5,800	6,200	5,100	.	.	4,500	4,800	5,100
GDP/capita (EUR at PPP)	13,100	13,300	13,700	13,500	.	.	.	.	.
Consumption of households, BYN mn, nom. <sup>2)</sup>	24,486	31,833	39,212	43,714	20,225	24,385	.	.	.
annual change in % (real) <sup>2)</sup>	10.8	10.9	4.3	-2.4	-2.1	-1.6	-1.0	0.0	1.0
Gross fixed capital form., BYN mn, nom. <sup>2)</sup>	17,845	24,430	26,369	24,835	10,598	9,908	.	.	.
annual change in % (real) <sup>2)</sup>	-11.3	9.6	-5.3	-15.9	-14.2	-18.3	-13.0	-3.0	2.0
Gross industrial production									
annual change in % (real)	5.8	-4.9	2.0	-6.6	-7.4	-1.6	-3.0	-1.0	2.0
Gross agricultural production									
annual change in % (real)	6.6	-4.2	2.9	-2.9	2.7	3.3	.	.	.
Construction industry									
annual change in % (real)	-8.6	4.6	-5.7	-11.3	.	.	.	.	.
Reg. employment, th, average	4,612	4,578	4,551	4,494	4,505	4,423	4,400	4,350	4,350
annual change in %	-1.7	-0.7	-0.6	-1.2	-1.2	-1.8	-2.1	-1.1	0.0
Reg. unemployed persons, th, end of period	24.9	21.0	24.2	43.3	46.8	47.2	50	50	50
Reg. unemployment rate, in %, end of period	0.5	0.5	0.5	1.0	1.0	1.1	1.1	1.1	1.1
Average monthly gross wages, BYN	368	506	605	671	646	699	740	820	910
annual change in % (real, gross)	21.5	16.4	1.3	-2.3	-2.9	-3.6	-1.0	0.0	1.0
Consumer prices, % p.a.	59.2	18.3	18.1	13.5	15.3	12.3	12.0	11.0	10.0
Producer prices in industry, % p.a. <sup>3)</sup>	76.0	13.6	12.8	16.8	17.7	14.0	15.0	13.0	11.0
General governm.budget, nat. def., % of GDP									
Revenues	38.5	40.3	38.7	42.7	43.2	42.6	40.0	39.0	39.0
Expenditures	37.7	40.1	37.3	41.2	39.3	40.9	39.0	38.0	38.0
Deficit (-) / surplus (+)	0.8	0.2	1.3	1.4	3.9	1.6	1.0	1.0	1.0
Public debt, EU-def., % of GDP	38.5	37.6	39.8	40.0	.	.	40.0	40.0	40.0
Central bank policy rate, % p.a., end of period <sup>4)</sup>	30.0	23.5	20.0	25.0	25.0	20.0	18.0	16.0	15.0
Current account, EUR mn <sup>5)</sup>	-1,446	-5,737	-4,057	-1,857	-813	-1,402	-1,000	-800	-600
Current account, % of GDP <sup>5)</sup>	-2.9	-10.5	-6.9	-3.8	-3.4	-7.1	-2.3	-1.8	-1.2
Exports of goods, BOP, EUR mn <sup>5)</sup>	35,391	27,701	27,492	23,854	12,056	9,904	20,000	20,500	21,000
annual change in %	24.2	-21.7	-0.8	-13.2	-11.6	-17.8	-16.2	2.5	2.4
Imports of goods, BOP, EUR mn <sup>5)</sup>	34,952	31,183	29,537	25,807	12,411	10,936	22,000	22,500	23,000
annual change in %	13.1	-10.8	-5.3	-12.6	-10.5	-11.9	-14.8	2.3	2.2
Exports of services, BOP, EUR mn <sup>5)</sup>	4,901	5,690	6,115	6,058	2,874	2,776	5,900	6,000	6,200
annual change in %	25.5	16.1	7.5	-0.9	2.8	-3.4	-2.6	1.7	3.3
Imports of services, BOP, EUR mn <sup>5)</sup>	3,140	3,983	4,449	3,985	1,819	1,877	3,900	3,800	3,900
annual change in %	34.5	26.8	11.7	-10.4	-14.7	3.2	-2.1	-2.6	2.6
FDI liabilities (inflow), EUR mn <sup>5)</sup>	1,137	1,703	1,445	1,506	1,266	805	1,000	.	.
FDI assets (outflow), EUR mn <sup>5)</sup>	121	199	57	97	70	24	100	.	.
Gross reserves of NB, excl. gold, EUR mn <sup>5)</sup>	4,390	3,589	2,820	2,510	3,254	2,874	.	.	.
Gross external debt, EUR mn <sup>5)</sup>	25,518	28,807	32,982	34,996	34,297	34,504	34,400	34,000	34,000
Gross external debt, % of GDP <sup>5)</sup>	51.9	52.5	56.0	71.7	70.3	80.2	80.0	75.0	70.0
Average exchange rate BYN/EUR	1.078	1.183	1.322	1.783	1.647	2.221	2.200	2.300	2.400
Purchasing power parity BYN/EUR	0.428	0.514	0.599	0.677	.	.	.	.	.

Note: 1 July 2016 denomination of the Belarusian rouble by 10,000. All time series in nominal and real terms as well as the exchange rates and PPP rates have been divided for statistical purposes by 10,000 to achieve the new currency BYN.

1) Preliminary. - 2) According to SNA'93 (FISIM not yet reallocated to industries). - 3) Domestic output prices. - 4) Refinancing rate of NB. - 5) Converted from USD.

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