
# BELARUS: Turning the corner?

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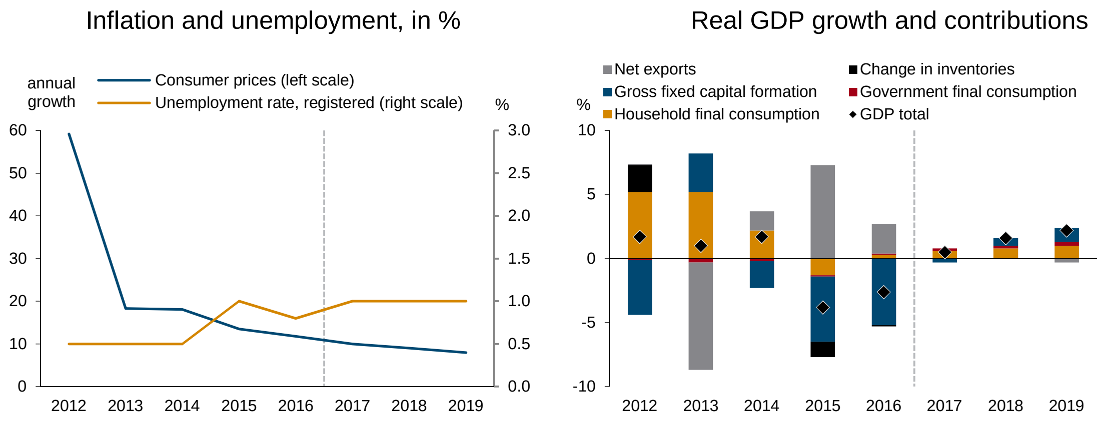
**The Belarus economy is undergoing a painful adjustment and a prolonged recession. In 2016, GDP plunged by 2.6%, after falling by 3.8% the previous year. A dispute with Russia over the pricing of gas provoked Russia to reduce its oil supplies, which hit the Belarusian processing industry and exports. At the same time, a change in policy helped lower inflation. The final months of the year brought some positive signs that growth may resume in the coming years.**

**Figure 34 / Belarus: Main macroeconomic indicators**




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

**In the last couple of years, the economy of Belarus has undergone a painful adjustment,** triggered by accumulated macroeconomic imbalances and balance-of-payments constraints. This has been coupled with a negative external shock due to the recession in Russia, Belarus's main trading partner, and shrinking Russian demand for imports. The collapse in world oil prices added to Belarus's problems, as it exports large quantities of refined oil. In 2016, the situation was aggravated further by a trade dispute with Russia over the pricing of Russian gas deliveries.

**These negative factors produced a deep and prolonged recession**, something that Belarus had not seen in the last 20 years. GDP dropped by an estimated 2.6% in 2016, after falling by 3.8% in 2015. Total domestic demand weakened further in 2016. Fixed investment was worst affected by the recession and the uncertain prospects for recovery. Real gross fixed capital formation has been declining for three consecutive years since 2014, and the dips were in the double-digits in both 2015 and 2016. Private consumption remained at near stagnation in 2016 as a whole: a drop in the first half was followed by a modest upturn in the second, thanks to some recovery in real incomes in the final months of the year.

**In 2016, both the processing industry and exports were negatively affected by the implications of a trade dispute with Russia over the pricing of Russian gas delivered to Belarus.** Despite numerous negotiations in the course of the year, the two sides have failed to reach any agreement on the price of Russian gas, with Belarus continuing to pay according to its interpretation. In the meantime, the Russian side has started counting the unpaid price difference as Belarusian debt, which has kept accumulating. According to Russian estimates, by January 2017 this debt stood at around USD 550 million.

**Last year, Russia started applying a retaliatory measure – cutting oil supplies to Belarus by an amount corresponding to the value of the estimated debt obligations.** As a result, Russia's oil deliveries to Belarus dropped in 2016 by 20.3%, compared to the previous year (from 22.77 million tonnes to 18.15 million). Belarus has only very small domestic oil reserves, and its economy is extremely dependent on deliveries from Russia, which is its only external supplier. Therefore, the cut in Russian oil supply had the effect of another negative external shock.

**Belarusian exports of goods in current prices dropped significantly in 2016** for the second year running, also reflecting negative shifts in the terms of trade. The downturn was most visible in the sectors affected by the reduced supply of Russian oil (such as oil refinery and chemical products). But exports of potassium fertilisers (one of Belarus's most important export commodities) also fell significantly in value terms (by some 23%), due to a plunge in world market prices for this commodity.

Importantly, **the last couple of years have also been a period of major macroeconomic policy change by the Belarusian authorities**. In 2015, the Belarusian central bank abandoned the previous policy regime of exchange rate targeting and turned to monetary targeting, while the exchange rate vis-à-vis a currency basket is only used as a reference point. Concomitant with this changeover, the overall macroeconomic policy stance (both monetary and fiscal) was tightened considerably. In 2015-2016 there was also a gradual reduction in government interventions in support of ailing state-owned enterprises (in particular, in the level of directed credit).

**These policy changes contributed to a further reduction in inflation and a stabilisation of the nominal exchange rate.** Quite remarkably, the exchange rate of the Belarusian rouble vis-à-vis the US dollar in December 2016 was virtually unchanged from January 2016. However, the relative stability of the nominal exchange rate mostly reflects the low level of currency purchases due to the depressed domestic demand. For all practical purposes, the currency redenomination implemented in July (crossing four zeros off the Belarusian rouble) had no effect on the price dynamics in the country.

**At the same time, these policy shifts had a negative effect on the financial state of the enterprise sector.** In particular, non-performing loans increased considerably in 2016: from 6.8% in December 2015 to 12.8% in December 2016, according to the official statistics. However, according to some experts, the official statistics may underestimate the true level of sub-standard loans on the banks' balance sheets. Overall, a further aggravation of this situation may become a threat to the stability of the financial system. The government also launched an Agency for Asset Management, with the aim of helping to clean up the balance sheets of commercial banks. In 2016, this agency took over non-performing loans amounting to BYN 600 million (about USD 300 million) from the books of 270 corporate entities (first and foremost agricultural firms).

**Registered unemployment reportedly fell in 2016, but Belarusian unemployment statistics are highly unreliable in the absence of labour force surveys.** At the same time, registered employment continued to decline, a process that has been under way since 2010 and that reflects both the longer-term effects of population ageing and the slack in state-owned companies. According to anecdotal evidence, labour shedding intensified considerably in both 2015 and 2016.

**The subdued domestic demand helped to reduce further the current account deficit.** Partly, this was also a forced adjustment due to the borrowing constraints that Belarus is facing. In recent years, the country's external debt has increased considerably, and its servicing has been a growing burden on the economy.

**Belarus is facing growing difficulties in accessing foreign finance.** Borrowing from Russia and Russia-backed financial institutions (such as the Eurasian Development Bank) has also been problematic. In March 2016, Belarus reached an agreement with the Eurasian Fund for Stabilisation and Development (an instrument of the Eurasian Development Bank) on a USD 2 billion loan due to be disbursed over the period 2016-2018. However, in 2016 there were only two disbursements totalling USD 800 million; a third tranche (worth USD 300 million) that was due in 2016 was suspended, due to a reported failure by Belarus to meet some aspects of the loan's conditionality. However, there has been speculation that the true reason for the suspension of funding was the unsettled dispute between Belarus and Russia in the energy sphere.

**Faced with a financial squeeze, Belarus approached the IMF in an attempt to negotiate a new funding programme.** However, so far the two sides have not been able to come to mutually agreeable terms. Reportedly, the restructuring of the state-owned part of the economy remains the biggest stumbling block in the negotiations. Belarus has also been seeking to re-establish closer economic cooperation with the EU as a way of partly offsetting the shrinking of the Russian market.

**While the overall economic picture remained gloomy throughout most of 2016, the final months brought some positive signs.** World oil prices started to rise, and this should have both direct (the exports of oil products) and indirect (through Russian imports) positive effects for the Belarus economy. The manufacturing industry was on the road to recovery in the second half of the year, and gross industrial output bottomed out in the fourth quarter, mirroring an upturn in export volumes. Preliminary estimates suggest that the decline in GDP and the value of exports also slowed in the final months of the year.

**Apparently, some additional growth impetus has come from a nascent recovery in private consumption.** This, in turn, was supported by an upturn in the second half of the year in real wages and personal incomes, thanks to disinflation and the stability of the nominal exchange rate. The recovery in real wages also reflects a lasting (often populist) policy commitment to the preservation of welfare as one of the pillars supporting the Belarusian economic model.

**The Belarusian authorities have declared their commitment to preserving the policy course of 2015-2016.** The overall macroeconomic stance should thus remain tight and financial interventions are expected to be reduced. Thus, the government announced its intention to reduce the level of newly extended directed credit (implicit subsidies) in 2017 to BYN 1.9 billion from BYN 2.8 billion in 2016. In relative terms, these levels are already far below the highs of previous years, and so their effect on macroeconomic performance is also declining.

**If the trends of the most recent months are extended, and if the policy course is maintained, the Belarusian economy may be turning the corner.** In a benign scenario, economic growth may resume, albeit modestly, as early as 2017 and continue in the following years. This upward revision of the previous wiiw forecast (which envisaged a continuation of the recession in 2017) reflects the signs of a possible economic revival seen in recent months, driven by an upturn in manufacturing. Further macroeconomic stabilisation and disinflation should support an upturn in private consumption, which, in turn, would provide an impetus to GDP growth. Progress in policy reform may also facilitate negotiations with the IMF and could enable a recovery in private fixed investment.

**Much will depend, however, on the settlement of the gas dispute with Russia and on the severity of the balance-of-payments constraints**. For the time being, in the absence of an agreement, Russia has announced further cuts in oil supplies to Belarus in 2017. As the servicing of the external debt is a serious burden on the Belarus economy, additional downside risks are associated with a possible failure to secure sufficient new external financing. In an unfavourable scenario, an aggravation of the trade dispute and/or of the restrictions on foreign borrowing could result in new negative shocks to the Belarusian economy. In this case, the continuation of the recession in Belarus cannot be excluded.

## Table 5 / Belarus: Selected economic indicators

| | 2012 | 2013 | 2014 | 2015 | 2016 1) | 2017 | 2018 Forecast | 2019 |
|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 9,465 | 9,466 | 9,475 | 9,490 | 9,500 | 9,520 | 9,540 | 9,560 |
| Gross domestic product, BYN mn, nom. 2) | 54,762 | 67,069 | 80,579 | 89,910 | 94,321 | 104,300 | 115,500 | 127,500 |
| annual change in % (real) | 1.7 | 1.0 | 1.7 | -3.8 | -2.6 | 0.5 | 1.6 | 2.2 |
| GDP/capita (EUR at PPP) | 13,400 | 13,400 | 13,900 | 13,700 | 13,500 | . | . | . |
| Consumption of households, BYN mn, nom. 2) | 25,999 | 33,970 | 42,082 | 47,006 | 50,880 | . | . | . |
| annual change in % (real) | 10.8 | 10.9 | 4.3 | -2.4 | 0.5 | 1.2 | 1.5 | 2.0 |
| Gross fixed capital form., BYN mn, nom. 2) | 18,299 | 24,941 | 26,772 | 25,763 | 22,750 | . | . | . |
| annual change in % (real) | -11.4 | 9.0 | -5.7 | -15.5 | -18.0 | -1.0 | 2.0 | 4.0 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | 5.8 | -4.9 | 2.0 | -6.6 | -0.4 | 2.0 | 3.0 | 4.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | 6.6 | -4.2 | 2.9 | -2.9 | 3.4 | . | . | . |
| Construction industry | | | | | | | | |
| annual change in % (real) | -8.6 | 4.6 | -5.7 | -11.3 | -18.4 | . | . | . |
| Reg. employment, th, average | 4,612 | 4,578 | 4,551 | 4,496 | 4,410 | 4,350 | 4,350 | 4,350 |
| annual change in % | -1.7 | -0.7 | -0.6 | -1.2 | -1.9 | -1.4 | 0.0 | 0.0 |
| Reg. unemployed persons, th, end of period | 24.9 | 21.0 | 24.2 | 43.3 | 35.3 | 40 | 40 | 40 |
| Reg. unemployment rate, in %, end of period | 0.5 | 0.5 | 0.5 | 1.0 | 0.8 | 1.0 | 1.0 | 1.0 |
| Average monthly gross wages, BYN | 368 | 506 | 605 | 671 | 722 | 800 | 880 | 960 |
| annual change in % (real, gross) | 21.5 | 16.4 | 1.3 | -2.3 | 1.5 | 0.5 | 1.0 | 1.5 |
| Consumer prices, % p.a. | 59.2 | 18.3 | 18.1 | 13.5 | 11.8 | 10.0 | 9.0 | 8.0 |
| Producer prices in industry, % p.a. 3) | 76.0 | 13.6 | 12.8 | 16.8 | 12.0 | 11.0 | 10.0 | 9.0 |
| General governm.budget, nat. def., % of GDP | | | | | | | | |
| Revenues | 37.3 | 39.0 | 37.3 | 41.3 | 40.9 | 39.0 | 39.0 | 39.0 |
| Expenditures | 36.5 | 38.8 | 36.1 | 39.9 | 39.8 | 38.0 | 38.0 | 38.0 |
| Deficit (-) / surplus (+) | 0.8 | 0.2 | 1.3 | 1.4 | 1.0 | 1.0 | 1.0 | 1.0 |
| Public debt, EU-def., % of GDP | 37.3 | 36.4 | 38.4 | 38.7 | 39.2 | 40.0 | 41.0 | 42.0 |
| Stock of loans of non-fin.private sector, % p.a | 37.0 | 28.8 | 21.1 | 19.4 | 6.5 | . | . | . |
| Non-performing loans (NPL), in %, Dec | 5.5 | 4.4 | 4.4 | 6.8 | 12.8 | . | . | . |
| Central bank policy rate, % p.a., end of period 4) | 30.0 | 23.5 | 20.0 | 25.0 | 18.0 | 16.0 | 15.0 | 14.0 |
| Current account, EUR mn 5) | -1,446 | -5,737 | -4,057 | -1,857 | -1,300 | -1,600 | -2,100 | -2,300 |
| Current account, % of GDP 5) | -2.8 | -10.1 | -6.7 | -3.7 | -3.0 | -3.5 | -4.4 | -4.5 |
| Exports of goods, BOP, EUR mn 5) | 35,391 | 27,701 | 27,492 | 23,854 | 20,500 | 21,700 | 22,500 | 23,800 |
| annual change in % | 24.2 | -21.7 | -0.8 | -13.2 | -14.1 | 5.9 | 3.7 | 5.8 |
| Imports of goods, BOP, EUR mn 5) | 34,952 | 31,183 | 29,537 | 25,807 | 23,000 | 23,800 | 24,700 | 26,000 |
| annual change in % | 13.1 | -10.8 | -5.3 | -12.6 | -10.9 | 3.5 | 3.8 | 5.3 |
| Exports of services, BOP, EUR mn 5) | 4,901 | 5,690 | 6,115 | 6,058 | 6,000 | 6,100 | 6,300 | 6,500 |
| annual change in % | 25.5 | 16.1 | 7.5 | -0.9 | -1.0 | 1.7 | 3.3 | 3.2 |
| Imports of services, BOP, EUR mn 5) | 3,140 | 3,983 | 4,449 | 3,985 | 3,800 | 4,000 | 4,100 | 4,200 |
| annual change in % | 34.5 | 26.8 | 11.7 | -10.4 | -4.6 | 5.3 | 2.5 | 2.4 |
| FDI liabilities, EUR mn 5) | 1,137 | 1,703 | 1,445 | 1,506 | 1,100 | . | . | . |
| FDI assets, EUR mn 5) | 121 | 199 | 57 | 97 | 100 | . | . | . |
| Gross reserves of NB excl. gold, EUR mn 5) | 4,390 | 3,589 | 2,820 | 2,510 | 3,071 | . | . | . |
| Gross external debt, EUR mn 5) | 25,518 | 28,807 | 32,982 | 34,996 | 36,400 | 36,300 | 36,100 | 35,700 |
| Gross external debt, % of GDP 5) | 50.2 | 50.8 | 54.1 | 69.4 | 84.9 | 80.0 | 75.0 | 70.0 |
| Average exchange rate BYN/EUR | 1.078 | 1.183 | 1.322 | 1.783 | 2.201 | 2.3 | 2.4 | 2.5 |

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 and wiiw estimates. - 2) According to SNA 2008. - 3) Domestic output prices. - 4) Refinancing rate of NB. - 5) Converted from USD.

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