BELARUS: Forced into a Russian orbit

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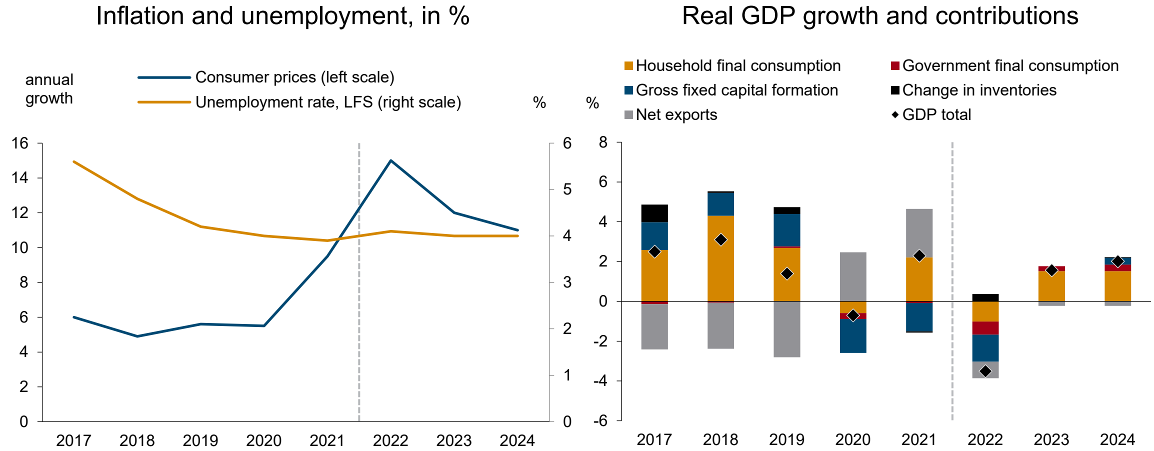
Lukashenko's support for Russia's invasion of Ukraine triggered fresh economic sanctions by major Western countries. Subsequently there has been a rapid deterioration in the economic situation and havoc on the financial markets. Being cut off from the West, Belarus sought aid from, and further economic integration with, Russia. However, the latter has limited resources to support its ally. Recession seems inevitable in 2022, and economic weakness will prevail in the following years as well.

Figure 4.2 / Belarus: Main macroeconomic indicators



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

President Lukashenko's decision to support Russia's invasion of Ukraine wrecked the few remaining economic ties between Belarus and the West. The major Western countries imposed fresh economic sanctions on Belarus, on top of the severe sanctions that were in already effect. To all intents and purposes, Belarus is currently labouring under a far-reaching political and economic blockade on its Western borders, which is likely to remain in place for a long time to come. A signal to this effect was the decision by some major Western states to block further consideration of Belarus's application to join the World Trade Organization (WTO). The European Commission has suspended its last remaining cooperation agreement with Belarus, that on cross-border cooperation under the European Neighbourhood programme. The European Bank for Reconstruction and Development (EBRD) has also announced the closure of its Minsk office.

Given the circumstances, Belarus had no choice but to further reorient itself towards parts of the world that have not joined in the sanctions. First and foremost, this means that economic integration with Russia can be expected to deepen even further. Indeed, there have already been several rounds of high-level meetings between Belarusian and Russian leaders to consider steps to improve bilateral economic ties. The measures either discussed or already agreed include the possibility of arranging oil and gas trade in Russian roubles; the establishment of alternative transportation routes for Belarusian exports that bypass the Baltic states; the abolition of remaining cross-border restrictions on passenger flows; and options for deferred repayment of Russian government credit. The two countries are discussing the possibility of switching entirely to trade based on their national currencies over the longer term. However, given Russia's weakened economy and its isolation from the international financial markets, Belarus cannot expect much short-term support from that quarter. Nor will it be easy for Belarus to find alternative foreign markets for the export flows that have been hit by sanctions.

The available short-term indicators suggest a rapid deterioration in the country's economic situation in the first months of 2022. Industrial production, which had picked up in 2021 on the strength of exports, witnessed a slump even in February. Some major industrial companies (such as the potash producer and exporter Belaruskali) have reported serious disruption and even partial halts to their activities.

The new financial sanctions, including the disconnection from SWIFT of several large Belarusian banks, have wreaked havoc on the local financial market. Visa cards and Mastercards issued by some Belarusian banks have either been blocked or operate with reduced functionality. Western Union, a company that specialises in cross-border money transfers, has also discontinued its operations in Belarus. All this has further increased pressure on the exchange rate, which had already plummeted in the aftermath of the Russian invasion of Ukraine. Some Belarusian banks have stopped extending credit to their clients; others have substantially reduced their credit activity.

The Belarusian authorities adopted a series of emergency policy measures, in an attempt to dampen the effect of the sanctions. A presidential decree issued in March stipulated additional support for businesses affected by the sanctions, additional export-promotion and export-support measures, options for deferred payments to the budget, tax reliefs and VAT exemptions for affected businesses, tariff relief for importers, etc. The government was also granted new powers to introduce other emergency support measures. One such measure, adopted due to the disruption to imports, was an embargo on the export of a range of foods and industrial goods. The government is also considering a simplification of the existing unwieldy regulations on public procurement.

In turn, the monetary authorities and the banks have introduced measures that seek to reduce volatility on the financial markets. The most visible of these are the caps on the withdrawal of forex deposits and various other restrictions on forex transactions, which amount to partial capital controls. On the other hand, as an alternative to the dollar and euro, Belarusian banks have increased the options for international payments in Chinese renminbi.

Inflation in Belarus has been rising since mid-2021. All the indications are that this trend will continue in 2022, driven by various domestic and external inflationary pressures. Average consumer price inflation for the year as a whole is expected to reach 15 per cent or even more.

The reduction in exports to traditional markets brought about by the sanctions has significantly cut export-related public revenue. This is particularly visible as regards the two most important sources of exports: petroleum products and potash fertilisers. The expected plunge in economic activity will also result in shrinking contributions to the budget, while the government has already committed itself to quite significant new spending, which was not envisaged earlier in the 2022 budget. Consequently, the deficit will rise in the current year. The government has already indicated that a budget revision will be forthcoming, including curbs on previously planned public spending.

The labour market has also been affected by the new shocks. The overall weakening of economic activity has forced businesses to lay off employees or introduce reduced-hours working. Some foreign companies have either closed or significantly scaled back their operations in Belarus. The once flourishing IT sector has also been severely affected: anecdotal evidence suggests that about a quarter of Belarus's IT specialists have left the country since 2020, and another quarter is considering following suit.

Servicing of the external debt will probably be the biggest challenge facing the Belarusian authorities in the foreseeable future. Belarus was already cut off from the international financial markets in 2020, but it continued to rely on financial support from Russia. However, in the current climate, Russia is itself under huge financial strain and may not be able to provide Belarus with sufficient support, even if such had previously been pledged. So far, Belarus has managed to honour its foreign obligations, but whether it can continue to service its debt remains an open question. The agreed rescheduling of payments due to Russia under intergovernmental agreements has somewhat eased the pressure on Belarus's external finances; however, no information has been made public on any such deferral as regards debt to the Eurasian Development Bank. In any case, the risk of possible default on some foreign obligations has increased. At the same time, the effect of the balance-of-payments constraints will be more and more visible, dampening all components of final demand.

The combined effect of the myriad negative developments will inevitably push the Belarusian economy into recession in 2022. Our current forecast is for GDP to drop by some 3-4 per cent for the year as a whole, but the risks of a deeper recession remain. Default on some foreign obligations is a possibility, and that would further aggravate the economic situation.

In the current circumstances, economic weakness can be expected to continue in coming years as well. If Belarus manages to adjust to some extent to the sanctions and the war-related shocks, the recession may be limited to 2022, with a weak recovery resuming in 2023. Both the servicing of foreign debt and the threats to macroeconomic stability will remain a challenge for policy makers.

Table 4.2 / Belarus: Selected economic indicators

	2018	2019	2020	2021 1)	2022	2023 Forecast	2024
Population, th pers., average	9,439	9,420	9,380	9,380	9,380	9,350	9,320
Gross domestic product, BYN m, nom.	122,320	134,732	149,721	173,153	192,100	218,500	247,400
annual change in % (real)	3.1	1.4	-0.7	2.3	-3.5	1.6	2.0
GDP/capita (EUR at PPP)	13,180	13,670	13,770	14,430	.	.	.
Consumption of households, BYN m, nom.	64,491	71,630	77,101	87,768	.	.	.
annual change in % (real)	8.0	5.1	-1.1	4.3	-2.0	3.0	3.0
Gross fixed capital form., BYN m, nom.	32,081	36,424	37,977	39,141	.	.	.
annual change in % (real)	4.4	6.2	-6.3	-5.6	-6.0	0.0	1.5
Gross industrial production							
annual change in % (real)	5.7	1.0	-0.7	6.5	-3.0	1.0	2.0
Gross agricultural production							
annual change in % (real)	-3.3	2.9	4.8	-4.2	.	.	.
Construction industry							
annual change in % (real)	5.2	5.1	-1.6	-14.0	.	.	.
Employed persons, LFS, th, average	4,897	4,909	4,885	4,849	4,800	4,750	4,750
annual change in %	-0.1	0.2	-0.5	-0.7	-1.0	-1.0	0.0
Unemployed persons, LFS, th, average	245	213	206	197	205	198	198
Unemployment rate, LFS, in %, average	4.8	4.2	4.0	3.9	4.1	4.0	4.0
Reg. unemployment rate, in %, eop	0.3	0.2	0.2	0.1	.	.	.
Average monthly gross wages, BYN	971	1,093	1,255	1,434	1,620	1,830	2,070
annual change in % (real, gross)	12.6	6.5	8.8	4.4	-2.0	1.0	2.0
Consumer prices, % p.a.	4.9	5.6	5.5	9.5	15.0	12.0	11.0
Producer prices in industry, % p.a. 2)	6.8	6.3	5.6	12.1	16.0	14.0	12.0
General governm. budget, nat. def., % of GDP							
Revenues	41.5	40.0	35.5	38.0	35.0	37.0	38.0
Expenditures	37.5	37.6	37.2	40.0	39.0	39.0	39.0
Deficit (-) / surplus (+)	4.0	2.4	-1.7	-2.0	-4.0	-2.0	-1.0
General gov. gross debt, nat. def., % of GDP 3)	47.5	41.0	48.0	50.0	53.0	54.0	55.0
Stock of loans of non-fin. private sector, % p.a.	12.7	10.0	21.4	3.3	.	.	.
Non-performing loans (NPL), in %, eop 4)	5.0	4.6	4.8	5.0	.	.	.
Central bank policy rate, % p.a., eop 5)	10.00	9.00	7.75	9.25	12.0	11.0	10.0
Current account, EUR m 6)	20	-1,115	-221	1,564	700	700	500
Current account, % of GDP	0.0	-1.9	-0.4	2.7	1.3	1.3	0.8
Exports of goods, BOP, EUR m 6)	28,409	28,932	24,890	33,106	30,800	31,700	32,100
annual change in %	11.8	1.8	-14.0	33.0	-7.0	2.9	1.3
Imports of goods, BOP, EUR m 6)	30,536	32,684	26,637	33,777	31,700	32,600	33,000
annual change in %	8.9	7.0	-18.5	26.8	-6.1	2.8	1.2
Exports of services, BOP, EUR m 6)	7,511	8,628	7,704	8,682	8,600	8,800	8,900
annual change in %	7.3	14.9	-10.7	12.7	-0.9	2.3	1.1
Imports of services, BOP, EUR m 6)	4,594	5,237	4,287	4,812	4,600	4,700	4,900
annual change in %	7.5	14.0	-18.1	12.3	-4.4	2.2	4.3
FDI liabilities, EUR m 6)	1,212	1,139	1,220	1,039	.	.	.
FDI assets, EUR m 6)	47	-3	67	-79	.	.	.
Gross reserves of CB excl. gold, EUR m 6)	4,561	6,265	3,604	4,687	.	.	.
Gross external debt, EUR m 6)	34,307	36,416	34,229	36,450	39,200	40,100	41,000
Gross external debt, % of GDP	67.3	63.1	63.8	63.0	75.5	73.4	69.7
Average exchange rate BYN/EUR	2.4008	2.3342	2.7888	2.9923	3.70	4.00	4.20

1) Preliminary and wiiw estimates. - 2) Domestic output prices. - 3) Including publicly guaranteed debt. - 4) Doubtful, bad and small part of supervised assets. - 5) Refinancing rate of CB. - 6) Converted from USD.

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