

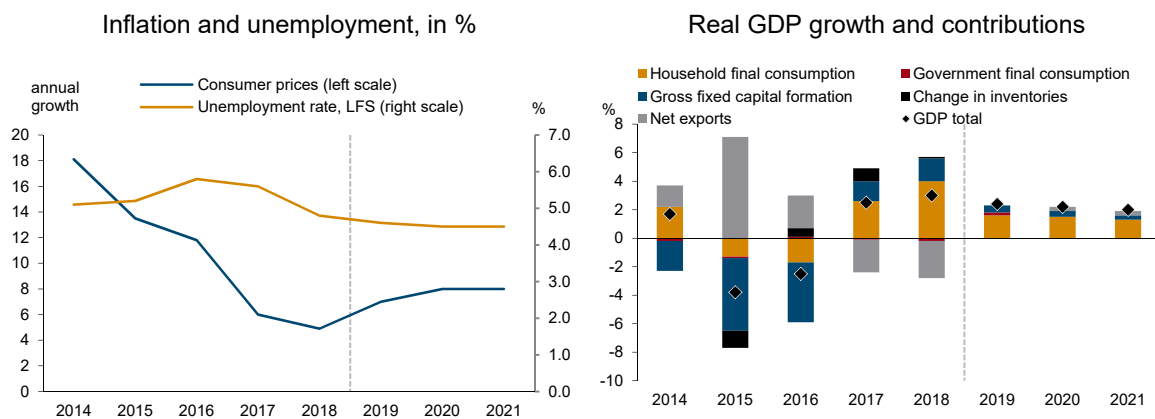


## BELARUS: Growth set to slow down

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Economic activity slowed down abruptly in the second half of 2018 due to a combination of domestic and external factors. These include changes in Russia's energy taxation system which affect Belarus. Private consumption remained the main growth driver thanks to rising income and a boom in consumer credit. There are no imminent threats to macroeconomic stability but the short-term prospects have deteriorated and the Belarusian economy is expected to slow down in the coming years.

Figure 6.2 / Belarus: Main macroeconomic indicators



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

**While the first half of 2018 was marked by a robust economic recovery, economic activity slowed down abruptly in the second half.** After the unexpectedly high 5.3% year-on-year rise recorded in the first quarter, GDP growth continuously slowed down in the course of the year to 3.9% in the second, 2.2% in the third quarter and came to a near standstill in the fourth quarter. According to the first official estimates average GDP growth for 2018 as a whole came to 3%.

**Such dynamics reflects the combined effect of several factors.** The high rates reported in the first half can partly be attributed to a low base but this base effect was diminishing in the course of the year (the recovery in Belarus started in the second half of 2017). Another factor contributing to the general economic slowdown was the drop in agricultural output in 2018 related to bad weather conditions. In addition to that, Belarus' external environment also changed with some unfavourable factors emerging in the second half of the year.

**Among them was the so-called Russian ‘tax manoeuvre’ initiated in 2018.** It amounts to a change in the redistribution of import and export duties within the Eurasian Economic Union requested by Russia which results in lower revenue for Belarus. The redistribution of duties which has been in force within the Eurasian Union makes it possible for countries like Belarus to generate windfall revenue from the re-export of Russian petroleum products. Under the new arrangement Belarus will be receiving a diminishing share of such duties. If fully introduced in the course of several years, the Russian ‘tax manoeuvre’ would eliminate the implicit subsidy to the Belarusian budget and support to the balance of payments that it receives from Russia. According to some estimates, the cumulative negative effect to Belarus over the period 2019-2024 (when the ‘tax manoeuvre’ will be fully phased in) may amount to the equivalent of USD 8bn.

**The start of partial implementation of these measures made the imports of Russian petroleum products less attractive for re-export.** Consequently, the imports of such products fell sharply in the second half of 2018: in November these exports amounted to just 24.3 ths tonnes whereas the average monthly imports in the first half of the year had exceeded 300 ths tonnes. This had a dampening effect on overall economic activity.

**In the months before the launch of the ‘tax manoeuvre’, Belarus also benefited from the surge in export prices related to higher petroleum prices in 2018.** Higher revenue from export tariffs boosted overall public revenue and generated a sizeable fiscal surplus. Such an outcome supported a surge in public investment, the policy of raising wages in the public sector as well as overall economic growth in the country. However, this source of windfall revenue started to dry up in the final months of the year.

**One of the important growth drivers throughout the year was final domestic demand, which continued its robust recovery.** In particular, private consumption grew by more than 7% in 2018 boosted by the significant increase in real wages in both 2017 and 2018 as the effects of the policy of raising wages in the public sector proliferated in the whole economy. Consequently, average real disposable income of the population increased by 8% in 2018. At the same time the overall macroeconomic stance (both monetary and fiscal) remained tight which, at least until now, prevented the emergence of an inflationary spiral.

**Private consumption was boosted further by a significant rise in consumer credit.** The stock of outstanding consumer credit grew by 46% in 2018. In January the central bank issued a statement expressing concern with this rise and its possible consequences for financial and macroeconomic stability.

**Despite this rapid credit expansion, the overall financial state of the banking sector stabilised in 2018.** The share of nonperforming loans (the overwhelming share of these loans is held by the corporate sector) fell from 12.9% at the end of 2017 to just 4.1% in December 2018. This outcome was due to two main factors. In the first place, the Belarusian central bank has been sticking to its tight policies which limits the capacity of banks to engage in new large-scale corporate lending. And second, in the last several years Belarus has been following a policy of gradual reduction of the so-called ‘directed lending’ (lending to state-owned firms included in different government programmes). The authorities have stated that such lending should be discontinued altogether but it is still too early to ascertain that this will happen in reality.

**Given the relatively positive economic situation, the servicing of Belarus' external debt did not pose serious problems.** In 2018 Belarus raised new external financing amounting to USD 2.35bn, of which, among others, USD 879m from Russia, USD 590m from Chinese banks and USD 600m from a Eurobond issue. In October, Belarus also received funding amounting to USD 200m from the Eurasian Development Bank which was the delayed sixth tranche from the USD 2bn funding agreement concluded in 2016. The servicing of the public external debt in 2018 amounted to USD 2bn.

**On average the main economic performance figures for 2018 were favourable.** Manufacturing output reported a strong upturn for the second consecutive year. Trade in goods and services also continued its recovery, with imports outpacing exports due to the strong domestic demand. Despite the surge in imports, the current account deficit remained manageable thanks to improving terms of trade. There were also some improvements in the labour market: the rate of unemployment declined in 2018 whereas the slashing of employment in large state-owned enterprises (which reflects an ongoing process of restructuring) was virtually put on hold.

**However, as noted, the average numbers for the year mostly reflect the positive trends in the first six months.** The second half was marked by a notable slowdown and deterioration in performance both as regards the real economy and as regards the macroeconomic stance. The dynamics of real gross industrial output is quite indicative to this effect: the growth of quarterly output decelerated from 9.3% year on year in the first quarter to 6.2% in the second, to 4.8% in the third and just 2.4% in the fourth quarter. Inflation, which was steadily subsiding until September, started to reverse its course in the last quarter, likely triggered by pressure coming from the surging wages.

**The short-term prospects for Belarus have deteriorated since the wiiw Autumn 2018 Forecast.** The start of the year 2019 was not very favourable either. Belarus and Russia have continued the negotiations on the implications of the Russian 'tax manoeuvre'. Belarus has been insisting on an eventual compensation of the negative effects on its economy. However, several meetings at the highest political level on this issue that already took place have so far not brought any solution agreeable to Belarus and this is a source of considerable uncertainty for the short-term economic prospects. As regards the real economy, the slowdown continued at the beginning of 2019 and the prospects for a reversal are dim. The government projections incorporated in the 2019 budget obviously did not take into account these negative developments and at the time of writing they look excessively optimistic: annual GDP growth of 4% and annual CPI inflation lower than 5%.

**As regards the servicing of the foreign debt, Belarus has been managing it rather skilfully and it already announced the tentative servicing schedule for 2019.** The servicing of the public external debt is estimated at USD 2.1bn; USD 600m of this is expected to be covered by new borrowing from Russia; another USD 700m from new bond issues and the rest from other sources. Belarus expects one more USD 200m disbursement from the Eurasian Development Bank – the final tranche under the 2016 agreement.

**We envisage a lowering of the GDP rate of growth to 2.4% in 2019 and further to around 2% in 2020 and 2021.** The demand-driven pattern of growth that prevailed in 2018 seems to have run its course and will probably be not so visible in the coming years. There are also considerable uncertainties related to the negative implications of Russia's new energy taxation system. In case Belarus does not manage to negotiate some concessions from Russia that would partly offset the negative effects of the

'tax manoeuvre', the GDP growth rates may be even lower. We do not see imminent threats to macroeconomic stability, provided the authorities maintain the relatively tight macroeconomic stance. As regards the latter, there are more risks on the fiscal side as one can expect a shortfall of public revenue. Inflation can also be expected to rise due to carry-over effects of the generous wage policy of the government. In case such policies are prolonged, this may lead to a reversal of the process of disinflation in the country.

Table 6.2 / Belarus: Selected economic indicators

	2014	2015	2016	2017	2018 <sup>1)</sup>	2019	2020	2021
						Forecast		
Population, th pers., average	9,475	9,490	9,502	9,498	9,484	9,470	9,450	9,430
Gross domestic product, BYN mn, nom.	80,579	89,910	94,949	105,748	121,600	133,200	147,100	162,000
annual change in % (real)	1.7	-3.8	-2.5	2.5	3.0	2.4	2.2	2.0
GDP/capita (EUR at PPP)	13,900	13,800	13,200	13,400	14,000	.	.	.
Consumption of households, BYN mn, nom.	42,082	47,006	51,122	56,843	64,500	.	.	.
annual change in % (real)	4.3	-2.4	-3.2	4.8	7.5	3.0	2.7	2.5
Gross fixed capital form., BYN mn, nom.	26,772	25,763	24,155	27,662	31,500	.	.	.
annual change in % (real)	-5.7	-15.5	-14.5	5.5	6.0	2.0	1.5	1.0
Gross industrial production								
annual change in % (real)	1.9	-6.6	-0.4	6.1	5.7	3.0	2.0	2.0
Gross agricultural production								
annual change in % (real)	3.1	-2.5	3.3	4.2	-3.4	.	.	.
Construction industry								
annual change in % (real)	-5.7	-11.3	-14.8	-3.7	2.2	.	.	.
Employed persons, LFS, th	.	.	4,862	4,902	4,920	4,900	4,880	4,860
annual change in %	.	.	.	0.8	0.4	-0.4	-0.4	-0.4
Unemployed persons, LFS, th	267	273	302	293	248	236	230	229
Unemployment rate, LFS, in %	5.1	5.2	5.8	5.6	4.8	4.6	4.5	4.5
Reg. unemployment rate, in %, eop	0.5	1.0	0.8	0.5	0.3	0.4	0.4	0.4
Average monthly gross wages, BYN	605.2	671.5	722.7	822.8	950.0	1,060	1,180	1,300
annual change in % (real, gross)	1.3	-2.3	-3.8	7.5	10.0	4.0	3.0	2.0
Consumer prices, % p.a.	18.1	13.5	11.8	6.0	4.9	7.0	8.0	8.0
Producer prices in industry, % p.a. <sup>2)</sup>	12.4	17.2	12.0	9.8	6.8	9.0	10.0	10.0
General governm.budget, nat. def., % of GDP								
Revenues	38.9	41.3	40.9	40.5	41.8	40.0	39.0	39.0
Expenditures	37.8	39.9	39.4	37.6	37.7	38.0	38.0	38.0
Deficit (-) / surplus (+)	1.0	1.4	1.5	3.0	4.1	2.0	1.0	1.0
General gov.gross debt, nat. def., % of GDP <sup>3)</sup>	38.8	53.0	53.5	53.4	44.0	43.0	42.0	41.0
Stock of loans of non-fin.private sector, % p.a.	21.1	19.4	-6.2	7.2	12.7	.	.	.
Non-performing loans (NPL), in %, eop <sup>4)</sup>	4.4	6.8	12.8	12.9	4.1	.	.	.
Central bank policy rate, % p.a., eop <sup>5)</sup>	20.0	25.0	18.0	11.0	10.0	11.0	11.0	11.0
Current account, EUR mn <sup>6)</sup>	-4,057	-1,669	-1,465	-789	-1,000	-1,300	-1,400	-1,500
Current account, % of GDP	-6.7	-3.3	-3.4	-1.6	-2.0	-2.5	-2.6	-2.7
Exports of goods, BOP, EUR mn <sup>6)</sup>	27,492	23,854	20,988	25,397	28,000	29,300	30,000	30,200
annual change in %	-0.8	-13.2	-12.0	21.0	10.3	4.6	2.4	0.7
Imports of goods, BOP, EUR mn <sup>6)</sup>	29,537	25,807	23,270	27,960	30,600	32,100	32,700	32,900
annual change in %	-5.3	-12.6	-9.8	20.2	9.4	4.9	1.9	0.6
Exports of services, BOP, EUR mn <sup>6)</sup>	6,115	6,048	6,203	6,944	7,200	7,700	8,000	8,100
annual change in %	7.5	-1.1	2.6	11.9	3.7	6.9	3.9	1.3
Imports of services, BOP, EUR mn <sup>6)</sup>	4,449	4,003	3,950	4,248	4,500	4,800	5,000	5,200
annual change in %	11.7	-10.0	-1.3	7.5	5.9	6.7	4.2	4.0
FDI liabilities, EUR mn <sup>6)</sup>	1,445	1,506	1,133	1,130	1,000	.	.	.
FDI assets, EUR mn <sup>6)</sup>	57	97	112	60	100	.	.	.
Gross reserves of NB excl. gold, EUR mn <sup>6)</sup>	2,820	2,510	3,071	4,502	4,561	.	.	.
Gross external debt, EUR mn <sup>6)</sup>	32,982	34,996	35,930	33,443	35,600	36,000	37,000	37,400
Gross external debt, % of GDP	54.1	69.4	83.3	69.0	70.3	69.0	68.0	67.0
Average exchange rate BYN/EUR	1.3220	1.7828	2.2010	2.1833	2.4008	2.6	2.7	2.9

1) Preliminary and wiiw estimates. - 2) Domestic output prices. - 3) Including publicly guaranteed debt. - 4) From 2018 NPL definition comprises doubtful, bad and small part of supervised assets (before that doubtful and large part of supervised assets were considered). - 5) Refinancing rate of NB. - 6) Converted from USD.

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