BELARUS: Recession continues

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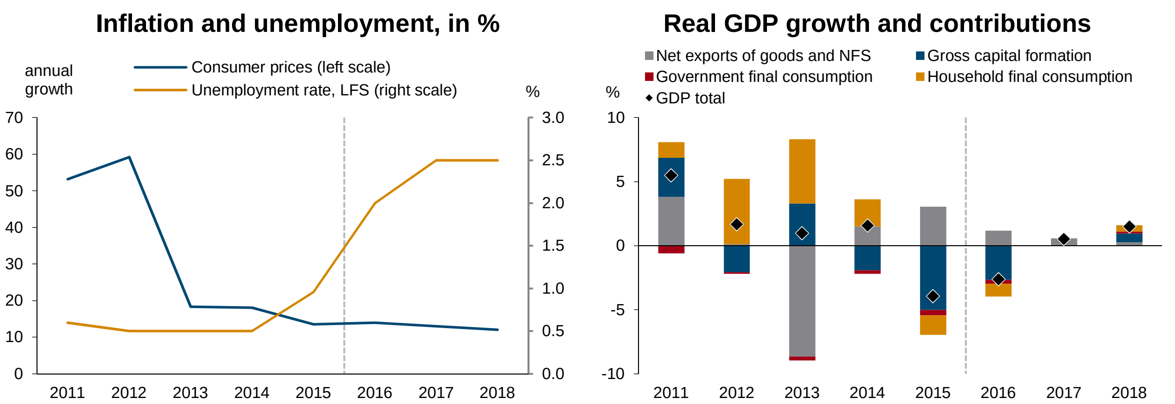
Belarus plunged into deep recession; GDP slumped by 4% in 2015. The crisis struck hard across the board, affecting all aspects of economic life, while policy-makers had little manoeuvring space in which to soften the blow. Short-term prospects are bleak as recession is likely to persist throughout 2016. A modest recovery may start in 2017, but it will be conditional on the revival of key export markets.

Figure 37 / Belarus: main macroeconomic indicators



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

The economy of Belarus slid into a deep recession in 2015 with GDP dropping by almost 4% for the year as a whole. The immediate causes of the crisis were external shocks originating in the plunge in the Russian economy and other key markets and mainly associated with the plummeting oil prices. At the same time, the depth of the recession revealed major vulnerabilities of the Belarusian economy related to chronic macroeconomic distortions which make it rather susceptible to such shocks.

The crisis struck hard across the board, affecting all sectors of economic activity and all aspects of economic life. In current dollar terms, total Belarusian exports fell by 26% in 2015, reflecting a plunge by 32% of exports to Russia and drops of similar magnitude in exports to other CIS countries. Apart from shrinking export demand, Belarusian exports were adversely affected by trade protection measures which were reportedly introduced by neighbouring countries, in the first place Russia, apparently in violation of the Eurasian Economic Union regulations.

As regards the real economy, the important manufacturing sector was most affected as it was directly exposed to the demand shock due to the shrinking exports to Russia. Production in sectors such as textiles, leather and footwear, plastics and rubber, pulp and paper fell by some 10-15% in 2015 while flagship sectors such as machine engineering and transport equipment experienced output drops by some 20-25%. There was also a significant drop (by some 10%) in construction output. Domestic demand was also seriously hit, with gross fixed capital formation plunging by 15% and private consumption by 3%.

The crisis brought severe distress to the population, which had enjoyed a decade and a half of relatively steady growth. Average real consumer wages in 2015 declined for the first time in more than 15 years. Moreover, due to the sharp exchange rate depreciation, average dollar wages in 2015 fell by 30%. The situation on the labour market also deteriorated considerably although the absence of LFS statistics makes it impossible to see a more accurate picture. The Belarusian media reported the widespread practice of reduced working hours (and hence lower pay) at manufacturing plants, a practice tolerated by the authorities in an attempt to prevent massive open layoffs. Registered unemployment also rose although reported levels can hardly be taken as meaningful.

Given the plunging exports, Belarus was faced with acute balance of payments constraints. Plus, it also faced increasing fiscal constraints both due to the recession but also due to lower oil duty revenue associated with the drop in the prices of oil products.[39] Faced with revenue shortages, the government kept curbing budgetary spending by introducing tight wage controls in the public sector and cutting public investment and government support to the state-owned industrial sector. Directed lending[40], which has for long been a source of implicit government subsidies for selected state-owned companies, started to decline: from a level of some 6% of GDP in 2013 and 2014 it fell to 5% in 2015 and is expected to drop further in 2016.

The authorities also applied a range of monetary measures in an attempt to curb macroeconomic imbalances. In 2015, the Belarusian National Bank introduced major changes in its monetary policy objectives and instruments. It switched from a quasi-fixed exchange rate regime to monetary targeting and a managed float based on a basket of three currencies (dollar, euro and Russian rouble). Within this change, the central bank policy rate should gradually become the main monetary policy instrument whereas interventions on the foreign exchanges market are to be considerably reduced. The declared longer-term policy objective of the central bank is to switch to inflation targeting at some future point. The practice of directed credit is basically incompatible with such monetary arrangements so the Belarusian National Bank has suggested its gradual phasing out. However, it remains to be seen whether the government will be ready to give up this instrument for direct intervention in the economy.

Under the new policy regime, the Belarusian rouble depreciated sharply in the course of 2015 and this trend continued in the first months of 2016. At the same time, the Belarusian National Bank considerably tightened the money supply with the aim to prevent inflationary spillovers through the exchange rate pass-through. The combination of monetary tightening and rigid wage controls did indeed curb domestic

[39] In accordance with the existing bilateral agreements, Belarus imports crude oil from Russia at preferential prices and re-exports refined oil products to both Russia but also to Western Europe. Oil duties have been a main source of budget revenue in Belarus.

[40] Directed lending in Belarus refers to a peculiar form of state support through preferential loans earmarked for selected economic sectors and activities (as identified in governmental programmes) at subsidised interest rates.

demand and helped prevent the outburst of very high inflation in 2015, in contrast to previous episodes of rouble depreciation.

The crisis was a major blow to policy-makers in a year when key presidential elections were held. Besides, unlike other past episodes of financial turmoil that Belarus had experienced, this time policy-makers had very little, if any at all, policy degrees of freedom to moderate the negative effects of the shocks. The habitual way of mitigating balance-of-payments strain in the past was larger foreign borrowing, mostly from Russia, and such resources were then used as a cushion for the economy and the population. An important difference in 2015 was that this time the shocks came from the East with the Russian economy itself in a deep recession and under severe financial constraints. Plus, the growing public foreign debt itself restrained the zeal of the authorities to seek additional debt on the international financial markets.

In 2015, Belarus continued to fund most of the balance of payments gap through official borrowing but at considerably lower levels than in previous years. In the first half of 2015, Belarus managed to raise some USD 2.5 billion from Russian sources (the Russian government and Sberbank); however, further attempts in the second half were futile. Belarus also officially requested financial support from the Stabilisation and Development Fund of the Eurasian Development Bank. The initial request for USD 3 billion was subsequently reduced to USD 2 billion but nevertheless, as of the moment of writing, the two sides had not yet reached an agreement on the terms of the loan. In May 2015, Belarus concluded a framework agreement with China on credit lines totalling USD 7 billion. However, up till now progress in the absorption of this funding has been rather limited. The lifting of the EU sanctions may ease Belarus's access to financial markets but high borrowing costs will continue to be a deterrent to such financing. It is thus becoming increasingly clear that, in order to address the persistent macroeconomic imbalances, policy needs to tackle the structural problems that give rise to such distortions.

In November, Belarus opened negotiations with the IMF on a new economic programme that could be supported by IMF financial assistance. Negotiations are still in their initial phases and it is by far not clear whether they will be concluded successfully. A key stumbling block is the reluctance by the authorities to take tough radical reform measures as well as the absence of clearly formulated positions of the authorities on the negotiations. While the government and the central bank are leaning towards a more pragmatic approach, including the acceptance of some of the long-standing IMF requirements such as speedy privatisation, elimination of directed credit and abandoning of wage targets, the influential presidential administration (without whose sanction no deal can be made) seems still to be very much against any radical moves in the policy course.

The internal policy disputes surfaced clearly in January 2016, when the government came up with an anti-crisis plan and a medium-term reform programme which was to some extent tuned to the IMF's requirements. The draft programme was not made public but reportedly it proposed a series of reform measures aimed at the establishment of a competitive environment on the domestic markets, including the restructuring and financial rehabilitation of the state-owned firms (as a preparatory step towards their privatisation), support to private entrepreneurship and small businesses and reduction of direct public intervention into the economy. However, these proposals were summarily discarded by the presidential administration; instead, the president came up with a counter directive targeting 'economic security', which in the main amounts to just some cosmetic changes to the present policy course of muddling through. Subsequently, the government came up with an amended programme reflecting the presidential directive in which the planned reforms were toned down considerably. It does envisage the reduction of directed credit to some 3% of GDP and the privatisation of about 60 state-owned firms in 2016; however, its main thrust is again the state patronage over the economy. It remains to be seen how long such a course can be sustained or whether it will be overtaken by events. At the same time, the administration does not seem to be willing to sacrifice the course towards macroeconomic stabilisation advocated by the central bank.

The short-term prospects for the Belarusian economy remain bleak and recession will likely persist in 2016. The balance of payments and fiscal constraints are likely to remain binding as regards the degrees of policy freedom therefore limiting the capacity of the authorities to pursue pro-active policies. Thus it can be expected that the course of fiscal and monetary austerity will be continued in the foreseeable future. Coupled with the ongoing downturn in export markets, this would result in a continuing slump in overall final demand. The forecast envisages a gradual and moderate recovery starting in 2017 which, however, will be conditional on the eventual revival of the key export markets.

Sustaining Belarus's macroeconomic stability in the long run hinges on the undertaking of deep and painful structural reforms. Despite the current reluctance of the authorities, the shift towards a more radical policy reform course seems inevitable; the main unknown is the timing of when this will happen.

Table 6 / Belarus: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017	2018
							Forecast	
Population, th pers., average	9,473	9,465	9,466	9,475	9,493	9,510	9,530	9,550
Gross domestic product, BYR bn, nom. 2)	297,158	530,356	649,111	778,095	869,702	965,500	1,097,000	1,247,400
annual change in % (real) 2)	5.5	1.7	1.0	1.7	-3.9	-2.6	0.5	1.5
GDP/capita (EUR at exchange rate)	3,900	5,200	5,800	6,200	5,100	4,200	4,300	4,400
GDP/capita (EUR at PPP)	12,500	13,100	13,300	13,700	13,500	.	.	.
Consumption of households, BYR bn, nom. 2)	139,955	244,863	318,332	392,116	442,000	.	.	.
annual change in % (real) 2)	2.3	10.8	10.9	4.3	-3.0	-2.0	0.0	1.0
Gross fixed capital form., BYR bn, nom. 2)	113,230	178,455	244,296	263,693	225,000	.	.	.
annual change in % (real) 2)	13.9	-11.3	9.6	-5.3	-15.0	-8.0	0.0	2.0
Gross industrial production								
annual change in % (real)	9.1	5.8	-4.9	2.0	-6.6	-4.0	0.0	2.0
Gross agricultural production								
annual change in % (real)	6.6	6.6	-4.2	2.9	-2.8	.	.	.
Construction industry								
annual change in % (real)	6.7	-8.6	4.6	-5.7	-10.0	.	.	.
Reg. employment, th, average	4,691	4,612	4,578	4,551	4,470	4,400	4,350	4,350
annual change in %	-0.3	-1.7	-0.7	-0.6	-1.8	-1.6	-1.1	0.0
Reg. unemployed persons, th, end of period	28.2	24.9	21.0	24.2	43.3	90.0	110.0	110.0
Reg. unemployment rate, in %, end of period	0.6	0.5	0.5	0.5	1.0	2.0	2.5	2.5
Average monthly gross wages, ths BYR	1,900	3,676	5,061	6,052	6,700	7,600	8,600	9,700
annual change in % (real, gross)	1.9	21.5	16.4	1.3	-2.5	-1.0	0.0	1.0
Consumer prices, % p.a.	53.2	59.2	18.3	18.1	13.5	14.0	13.0	12.0
Producer prices in industry, % p.a. 3)	71.4	76.0	13.6	12.8	16.8	18.0	16.0	14.0
General governm.budget, nat. def., % of GDP								
Revenues	38.7	38.5	40.3	38.7	41.0	40.0	39.0	39.0
Expenditures	35.9	37.7	40.1	37.3	39.0	39.0	38.0	38.0
Deficit (-) / surplus (+)	2.8	0.8	0.2	1.3	2.0	1.0	1.0	1.0
Public debt, EU-def., % of GDP	45.9	38.5	37.6	39.8	40.0	40.0	40.0	40.0
Central bank policy rate, % p.a., end of period 4)	45.0	30.0	23.5	20.0	25.0	24.0	22.0	20.0
Current account, EUR mn 5)	-3,518	-1,446	-5,737	-4,034	-1,000	-1,000	-1,100	-1,200
Current account, % of GDP 5)	-9.5	-2.9	-10.5	-6.9	-2.0	-2.5	-2.7	-2.9
Exports of goods, BOP, EUR mn 5)	28,499	35,391	27,701	27,492	24,000	23,500	23,300	23,500
annual change in %	55.6	24.2	-21.7	-0.8	-12.7	-2.1	-0.9	0.9
Imports of goods, BOP, EUR mn 5)	30,913	34,952	31,183	29,537	26,500	25,800	26,000	26,400
annual change in %	22.4	13.1	-10.8	-5.3	-10.3	-2.6	0.8	1.5
Exports of services, BOP, EUR mn 5)	3,906	4,901	5,690	6,113	6,000	5,900	6,000	6,200
annual change in %	9.0	25.5	16.1	7.4	-1.8	-1.7	1.7	3.3
Imports of services, BOP, EUR mn 5)	2,334	3,140	3,983	4,424	4,000	3,900	3,800	3,900
annual change in %	3.9	34.5	26.8	11.1	-9.6	-2.5	-2.6	2.6
FDI liabilities (inflow), EUR mn 5)	2,787	1,137	1,703	1,445	1,500	.	.	.
FDI assets (outflow), EUR mn 5)	87	121	199	57	100	.	.	.
Gross reserves of NB, excl. gold, EUR mn 5)	4,648	4,390	3,589	2,820	2,510	.	.	.
Gross external debt, EUR mn 5)	26,305	25,518	28,807	32,982	35,100	32,200	31,700	31,200
Gross external debt, % of GDP	71.3	51.9	52.5	56.0	72.0	80.0	78.0	75.0
Average exchange rate BYR/EUR	8,051	10,778	11,834	13,220	17,828	24,000	27,000	30,000
Purchasing power parity BYR/EUR	2,504	4,283	5,145	5,985	6,771	.	.	.

1) Preliminary and wiiw estimates. - 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.