

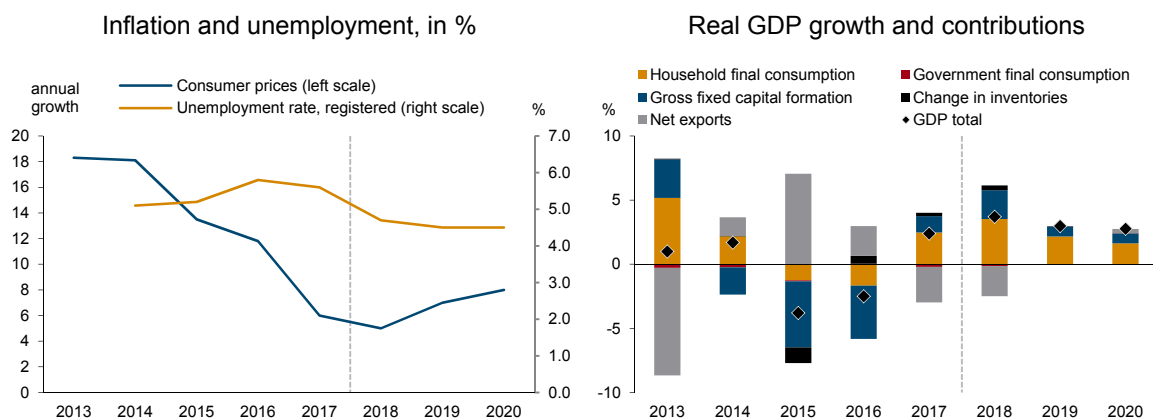


BELARUS: Recovery driven by external factors and policy stimulus

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The economy has rebounded thanks to an improving external environment and a policy stimulus engineered through wage rises. Real disposable income rose sharply supporting an upturn in private consumption. GDP growth was entirely driven by domestic demand while net exports made a negative contribution. Recent indicators suggest that growth has passed its peak and will decelerate. In 2018 as a whole GDP could rise by 3.7%, but thereafter will likely slow down to around 3% in the following years.

Figure 37 / Belarus: Main macroeconomic indicators



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

The average rate of GDP growth in the first half of the year (4.5%) was well above expectations. The economy rebounded strongly in the first quarter with GDP growing by 5.2% year on year, but its growth moderated to 3.9% in the second quarter. The most recent developments seem to indicate that growth may further decelerate in the short term.

The notable recovery in output at the beginning of 2018 followed several years of sluggish economic performance. The upturn resulted from a combination of a favourable external environment and a strong policy push. Rising oil prices and the recovery of Russian import demand supported a sharp upturn in manufacturing (gross manufacturing output grew by 7.4% year on year in January-August), as well as in merchandise exports (by 19.2% year on year in current dollar terms in January-July). Exports of services also grew strongly.

In addition to the improving external economic environment, the recovery was also supported by policy stimulus. This was engineered mainly by increasing wages in the public sector which started in the second half of 2017 and continued through 2018. Consequently, wage rises proliferated in the whole economy and as a result average real wages in Belarus grew by 13.4% year on year in the first half of 2018, while real disposable income grew by 7.7% year on year in January-July. The surge in real disposable income and the rising consumer sentiment produced a sharp upturn in private consumption which increased by almost 10% year on year in the first six months of 2018. Private consumption was boosted further by a significant rise in consumer credit (the stock of such credit grew by 31% year on year in September 2018).

As an indication of the improving business expectations, gross fixed capital formation also rebounded in 2018. It grew by an impressive 17% year on year in the first quarter and 7% in Q2, resulting in an overall year-on-year growth of 11.2% in the first six months. Improving business sentiment and the resumption of public investment projects contributed to this upturn. Thus economic growth in the first half of the year was supported by both external factors and domestic demand. In statistical terms, since the third quarter of 2017, GDP growth has been driven by domestic demand (both private consumption and fixed investment) while with the recovery of import demand, net exports have made a persistently negative contribution to GDP growth.

However, recent short-term economic indicators suggest that GDP growth may have passed its peak, and will likely decelerate in the near future. Growth of gross industrial output fell from 9.3% in the first quarter to 6.2% in Q2, and will probably be below 5% in the third quarter. In current dollar terms, the rate of growth of the exports of goods (balance-of-payments statistics) fell from 26.8% year on year in the first quarter to 14.6% in the second quarter. The current slowdown likely reflects the phasing out of both the windfall effect of the rising oil prices and of the push generated by the wage stimulus. Obviously, the latter should also be regarded as a one-off factor as a continuation of persistently and disproportionately rising wages could lead to macroeconomic destabilisation.

Recently the National Statistical Committee of Belarus started publishing the results of labour force surveys conducted in accordance with the ILO methodology. Thus, in addition to the statistics on registered unemployment, for the first time there are more reliable official estimates of the level of unemployment in the country. According to these data, the rate of unemployment in the first half of 2018 was 4.9%, down from 6% a year earlier. At the same time, all indications are that the recovery did not contribute to a significant net new job creation. This likely reflects the ongoing restructuring of some large SOEs which is associated with a lasting process of labour shedding and a concomitant shrinking of the labour force.

So far the loosening of wage policy in Belarus has not translated into inflationary pressure. Somewhat surprisingly, CPI growth continued to decelerate in the first half of the year and average annual inflation in 2018 will probably be the lowest on record. This was partly the result of the tight monetary stance (which has been in place during the past 3-4 years) and the continued reduction in the allocations of directed credit to state-owned firms. However, given that the rise in real wages has considerably surpassed productivity growth, it may be just a matter of time until both cost push and demand pull factors start driving inflation up.

Belarus's current account deficit rose slightly year on year in the first half of 2018 but remains under control. Rising domestic demand produced a deterioration in the balance of trade in goods but this was partly compensated by an improving balance on the services account. In the same period, the country's fiscal position improved mostly thanks to rising budget revenue from VAT and export taxes.

In August, President Lukashenko, who is endowed with wide-ranging constitutional powers, executed an almost complete changeover of the government. This included changes at the prime minister level and at most of the key ministries. The official justification of this shakeup was to revitalise the government's efforts towards implementing the policy course prescribed from the top and thus to invigorate economic performance.

However, it is unlikely that these measures will produce the expected results. The main problems that the authorities are facing at present seem to be associated with the policy course itself and not in the people entrusted with its implementation. In particular, the reluctance of the administration to engage in some unfinished market reforms such as the restructuring of the large state-owned enterprises and, related to that, the reform of the labour market as well as the further liberalisation of domestic markets. Due to the hesitancy of the authorities to make concrete commitments in these areas, Belarus did not manage to conclude an agreement on a new IMF-supported programme in 2017; the resumption of these negotiations is scheduled only for 2020.

In these circumstances Belarus continues to depend on Russia to a large degree as a source of external funding. In 2018 the two countries resumed negotiations for a new funding agreement amounting to USD 1.4bn, which is mostly intended for the refinancing of past debt. Belarus also hopes to receive the remaining USD 400m from the USD 2bn funding agreement with the Eurasian Development Bank concluded in 2016 in the final months of 2018 and the beginning of 2019. The disbursement of the last tranches was temporarily halted at the beginning of the year due to the delays on the Belarusian side in implementing some of the committed policy measures.

During the first half of 2018 the forex market remained more or less balanced. There were no big fluctuations in the nominal exchange rate whereas the real effective rate continued to appreciate. This reflects, among other factors, the positive net inflow of forex on the market which also contributed to a rise in international reserves.

However, Belarus will continue to face balance-of-payments challenges in the years ahead due to the large stock of public foreign debt. According to some estimates the annual servicing of this debt in the coming years will amount to around 7% of GDP. Therefore there will be a dire need for new external borrowing for the refinancing of the debt and most likely Belarus will need to seek access to the international financial markets.

The short-term prospects for the Belarusian economy remain generally favourable but have deteriorated since the previous forecast. In 2018 as a whole GDP should grow by 3.7% but growth will likely decelerate to around 3% in the following years due to the gradual phasing out of the effects generated by positive external factors and loose domestic policy. While oil prices are expected to remain at levels that are favourable for Belarus, this would not generate new impulses of economic activity. In turn, the government does not have many degrees of freedom to continue the current course of policy loosening for an extended period of time as it may endanger macroeconomic stability in the country. If policy-makers remain committed to stability (as they have been claiming recently), they will need to reduce or withdraw the stimulus altogether in the near future. This would lead to a further moderation of growth. Future growth will also depend on the situation in the world oil market and the state of the Russian economy, Belarus's main trading partner. There are no imminent risks to macroeconomic stability but inflation is likely to accelerate in the coming years.

Table 12 / Belarus: Selected economic indicators

	2014	2015	2016	2017 ¹⁾	2017 January-June	2018	2018 Forecast	2019 Forecast	2020
Population, th pers., average	9,475	9,490	9,502	9,498	.	.	9,480	9,450	9,420
Gross domestic product, BYN mn, nom.	80,579	89,910	94,949	105,199	47,642	55,910	114,500	126,200	140,100
annual change in % (real)	1.7	-3.8	-2.5	2.4	1.1	4.5	3.7	3.0	2.8
GDP/capita (EUR at PPP)	13,900	13,900	13,300	13,700	.	.	.	.	.
Consumption of households, BYN mn, nom.	42,082	47,006	51,122	57,022	26,607	30,600	.	.	.
annual change in % (real)	4.3	-2.4	-3.2	4.6	1.2	9.6	6.5	4.0	3.0
Gross fixed capital form., BYN mn, nom.	26,772	25,763	24,155	26,312	10,253	12,780	.	.	.
annual change in % (real)	-5.7	-15.5	-14.5	5.0	-2.2	11.5	9.0	3.0	3.0
Gross industrial production									
annual change in % (real)	1.9	-6.6	-0.4	6.1	6.1	7.8	6.0	4.0	3.0
Gross agricultural production									
annual change in % (real)	3.1	-2.5	3.3	4.2	-0.8	1.7	.	.	.
Construction industry									
annual change in % (real)	-5.7	-11.3	-14.8	-3.7	.	.	.	.	.
Employed persons, LFS, th	.	.	4,862	4,902	.	.	4,920	4,900	4,880
annual change in %	.	.	.	0.8	.	.	0.4	-0.4	-0.4
Unemployed persons, LFS, th	267	273	302	293	310	250	243	231	230
Unemployment rate, LFS, in %	5.1	5.2	5.8	5.6	6.0	4.9	4.7	4.5	4.5
Reg. unemployment rate, in %, eop	0.5	1.0	0.8	0.5	0.8	0.4	0.4	0.4	0.4
Average monthly gross wages, BYN	605.2	671.5	722.7	822.8	767	909	960	1,060	1,170
annual change in % (real, gross)	1.3	-2.3	-3.8	7.5	2.6	13.3	10.0	3.0	2.0
Consumer prices, % p.a.	18.1	13.5	11.8	6.0	6.9	4.7	5.0	7.0	8.0
Producer prices in industry, % p.a. ²⁾	12.4	17.2	12.0	9.8	9.1	7.1	8.0	9.0	10.0
General governm.budget, nat. def., % of GDP									
Revenues	38.9	41.3	40.9	40.7	42.1	43.7	41.0	40.0	39.0
Expenditures	37.8	39.9	39.4	37.8	38.9	37.6	38.0	38.0	38.0
Deficit (-) / surplus (+)	1.0	1.4	1.5	3.0	3.2	6.1	3.0	2.0	1.0
General gov.gross debt, nat. def., % of GDP ³⁾	38.0	53.0	53.9	48.0	.	.	47.0	46.0	45.0
Stock of loans of non-fin.private sector, % p.a.	21.1	19.4	-6.2	7.2	-7.5	10.3	.	.	.
Non-performing loans (NPL), in %, eop	4.4	6.8	12.8	12.9	.	.	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	20.0	25.0	18.0	11.0	13.0	10.0	10.0	11.0	11.0
Current account, EUR mn ⁵⁾	-4,057	-1,669	-1,465	-761	-308	-684	-1,200	-1,400	-1,600
Current account, % of GDP	-6.7	-3.3	-3.4	-1.6	-1.3	-2.9	-2.5	-2.8	-3.1
Exports of goods, BOP, EUR mn ⁵⁾	27,492	23,854	20,988	25,421	12,503	13,369	27,100	29,100	30,300
annual change in %	-0.8	-13.2	-12.0	21.1	28.2	6.9	6.6	7.4	4.1
Imports of goods, BOP, EUR mn ⁵⁾	29,537	25,807	23,270	27,956	13,280	14,521	30,100	32,200	33,300
annual change in %	-5.3	-12.6	-9.8	20.1	23.3	9.3	7.7	7.0	3.4
Exports of services, BOP, EUR mn ⁵⁾	6,115	6,048	6,203	6,944	3,310	3,441	7,300	7,800	8,100
annual change in %	7.5	-1.1	2.6	11.9	20.9	3.9	5.1	6.8	3.8
Imports of services, BOP, EUR mn ⁵⁾	4,449	4,003	3,950	4,248	1,932	2,015	4,400	4,700	5,000
annual change in %	11.7	-10.0	-1.3	7.5	5.8	4.3	3.6	6.8	6.4
FDI liabilities, EUR mn ⁵⁾	1,445	1,506	1,133	1,130	808	923	1,300	.	.
FDI assets, EUR mn ⁵⁾	57	97	112	60	30	12	100	.	.
Gross reserves of NB excl. gold, EUR mn ⁵⁾	2,820	2,510	3,071	4,502	4,233	4,259	.	.	.
Gross external debt, EUR mn ⁵⁾	32,982	34,996	35,930	33,443	34,119	33,756	33,500	33,900	34,200
Gross external debt, % of GDP	54.1	69.4	83.3	69.4	70.8	70.8	70.3	68.5	66.0
Average exchange rate BYN/EUR	1.3220	1.7828	2.2010	2.1833	2.0345	2.3969	2.4	2.6	2.7

1) Preliminary. - 2) Domestic output prices. - 3) Including publicly guaranteed debt. - 4) Refinancing rate of NB. - 5) Converted from USD.

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