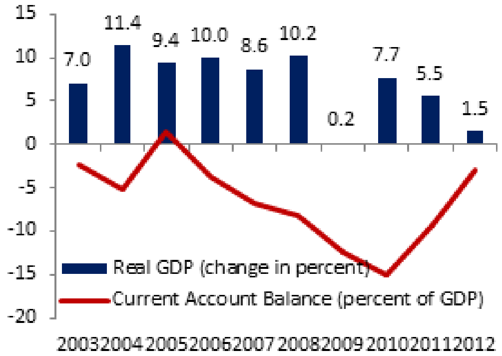
THE WORLD BANK

BELARUS Economic Update

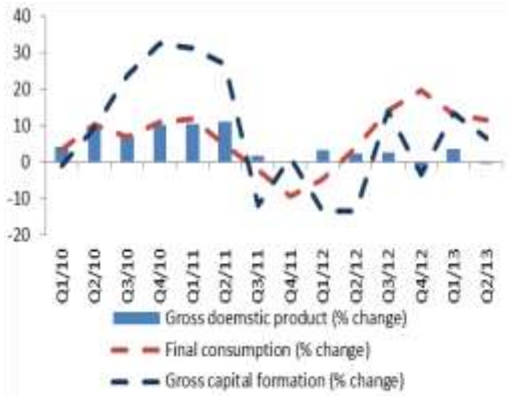
October 2013

- ***Real GDP growth is projected to decelerate in 2013 because of a weak external environment and slowing domestic demand.***
- ***External imbalances have reemerged and foreign exchange reserves are coming under pressure.***
- ***Consistent macroeconomic policies and structural reforms are needed to overcome external imbalances and achieve sustainable growth.***

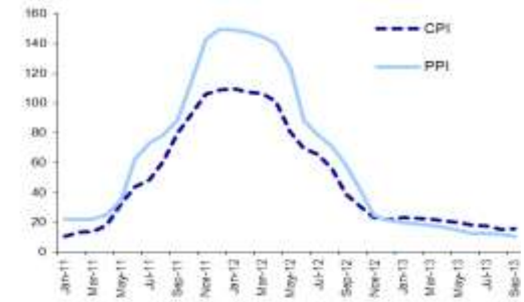


Recent Economic Developments

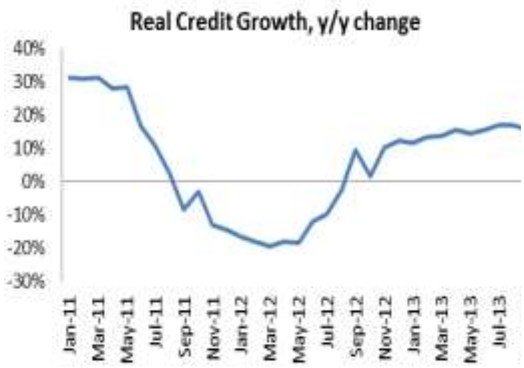
Over January-Sept 2013, real GDP grew by 1.1 percent, down from 3.2 percent during the same period of 2012. Many sectors saw declines in output, including industry (-4.6 percent) and agriculture (-2.2 percent). This was partially offset by growth in retail trade (18.6 percent), which was boosted by real wage increases and construction (5.9 percent), which was fuelled by credit growth, including under government programs. The decline in net exports – already rapid during the first quarter – accelerated in the second quarter because of a slowdown in Russia and falling prices for potash exports after the cartel between Belaruskali and Uralkali was dissolved. Domestic demand continued to expand, driven by wage and credit growth, but the pace of investment and consumption growth has been slowing and the economy contracted during the second quarter of 2013.



Inflationary pressures persist, exacerbated by a stop and go monetary policy. Reacting to slower than expected economic performance in early 2013 the NBRB cut the refinancing rate from 30 percent at the beginning of 2013 to 23.5 percent in June. Inflationary pressures, while continuing to subside, remained in double digits at 15.4 percent (Sept'13, y/y) and above the inflation in main trading partners. As a result, the real exchange rate continues to appreciate (by 4.6 percent since Dec'12), despite nominal currency depreciation. Meanwhile, devaluation expectations remain high, as evidenced by growing demand for foreign cash (net purchases of foreign currency were close to 1 billion USD over July-Sept) and a high share of foreign currency deposits (about 60 percent).



Current account pressures have re-emerged as a result of a sharp contraction of net exports. In Jan-Aug 2013, a rapid decline in exports (-22.7 percent, in fob prices) outpaced the decline in imports (-10.4 percent), resulting in a merchandize trade deficit of almost US$ 2 billion (down from a US$ 2.3 billion surplus a year ago), equal to 2.8 percent of annualized GDP. The widening trade deficit together with negative net transfers of custom duties on oil exports remained the major drag on the current account deficit, which exceeded US$ 3 billion (or 4.6 percent of annualized GDP) during the first half of 2013. Foreign reserves (excl. Monetary Gold) have been declining since the beginning of the year, dropping to US$ 5.5 billion or about 1.6 months of imports. Balance of Payment pressures are exacerbated by large external debt repayment needs, including to the IMF.



The economic slowdown dampened fiscal revenues, but expenditure cuts led to a fiscal surplus. In Jan-July 2013, revenues from profit taxes and taxes on international trade declined in real terms by 5.9 and 18.4 percent, y/y, respectively, being partially offset by strong growth in excise taxes (38.1 percent). On the expenditure side, measures were taken to contain growth of capital expenditures, while employment cuts in the civil service also eased the pressure. As a result, GG budget surplus was around 1.1 percent of annualized GDP.

Medium Term Outlook

Looking ahead, Belarus is facing substantial headwinds. Our forecast is based on the expectation that external pressures, including the commitments made under EURASEC Anti-Crisis Fund, would accentuate macroeconomic policies to contain domestic demand for the remainder of Q4'13 and throughout 2014. As a result, growth is expected to decelerate to around 1 percent in 2013, accelerating slightly to 1.5 percent in 2014. Despite this slowdown, we expect inflation to remain above 15 percent (eop) through the projection period, due to expected tariff increases and continued nominal rubel depreciation. The current account deficit is expected to widen to 8.9 percent of GDP in 2013 and adjust moderately to 8.1 percent of GDP as a result of domestic demand containment in 2014. Gross external financing needs are exacerbated by significant external repayment obligations on long term external debt (including IMF), which put significant pressure on the sustainability of the BOP. With lower than expected FDI inflows, meeting these financing needs will be challenging, especially in an environment of liquidity tightening at global financial markets. Shallow fiscal deficits are expected to emerge, as weak economic performance will continue to dampen fiscal revenues while higher than expected interest rate subsidies and external debt service payments (due to rubel weakening) will put upward pressure on expenditures. Over the medium term, we expect growth rates to accelerate moderately, driven by a recovery of both external demand (with strengthening growth in Russia and the EU) and domestic demand (with a return to looser macroeconomic policies especially in 2015 which is an election year).

Given Belarus' precarious external position, consistent, stabilization oriented macroeconomic policies are needed to prevent a further deterioration of its balance of payments. The key parameters of this policy framework should pertain to (i) maintaining the flexible exchange rate regime; (ii) tightening monetary policy, namely containment of credit growth, including under government directed lending programs; (iii) balancing real wage growth with labor productivity growth; and (iv) further tightening of fiscal policy through reduction of expenditures, especially of subsidies in order to maintain a balanced budget over the medium term (v) deep and comprehensive structural reforms to strengthen competitiveness and productivity led growth (more detailed structural policy options are included in the special focus note attached).

	2011	2012	2013	2014	2015
Nominal GDP, BRB billion	297158	527385	612558	715008	838704
Real GDP, % growth	5.5	1.5	1.0	1.5	2.0
Consumption, % growth	1.0	8.2	11.6	0.5	3.1
Investment, % growth	13.9	-9.8	5.8	-2.8	2.0
Export of Goods and Services, % growth	30.4	10.1	-6.5	2.5	1.6
Import of Goods and Services, % growth	18.5	11.2	1.3	-0.3	2.5
CPI, % eop growth	108.7	21.8	15.6	15.2	16.2
Current Account Balance, % GDP	-10.6	-2.9	-8.9	-8.1	-9.2
General Government Revenues, % GDP	38.7	40.7	39.6	39.3	39.0
General Government Expenditures, % GDP	35.9	40.0	40.3	40.8	41.1
General Government Balance, % GDP	2.8	0.7	-0.7	-1.5	-2.1
External debt, % GDP	57.9	53.5	56.7	63.0	62.7
PPG debt, % GDP	31.6	31.5	31.5	31.5	31.6

Source: World Bank Staff Estimates.

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