THE WORLD BANK

BELARUS Economic Update

March 2014

- ***Real GDP growth slowed further to 0.9% in 2013, accompanied by larger external imbalances, persistent inflation and low international reserves.***
- ***Securing macroeconomic stability by containing credit and wage growth should take priority over achieving domestic demand driven growth in the short term.***
- ***Fundamental structural reforms are urgently needed to enhance productivity and competitiveness of enterprises to put Belarus on a sustainable growth path.***

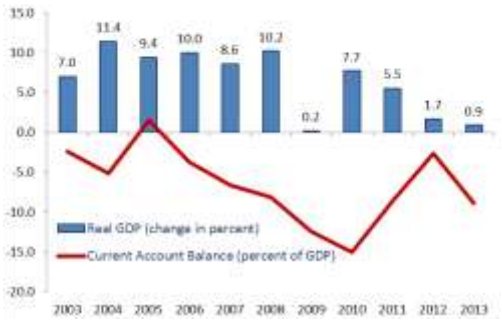
Recent Economic Developments

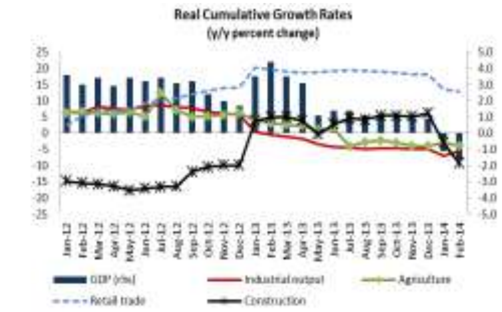
Amidst weak external conditions and limited room for further domestic demand expansion, real GDP growth continued to slow to 0.9% in 2013 (down from 1.7% in 2012). Low external demand for Belarussian manufacturing caused industrial output to decline by -4.8% while agricultural production dropped by -4.0%. Weak performance in the tradable sectors was partially offset by strong growth in non-tradable sectors. Retail and wholesale trade (18.2% and 4.2% respectively) was boosted by rising real incomes while growth in the construction sector (6.1%) was fuelled by a credit expansion under Government Directed Lending programs, especially during the first half of the year. The trend of decelerating economic activity continued during the first two months of 2014, with GDP contracting by -1.6% y/y in all sectors, except retail trade.

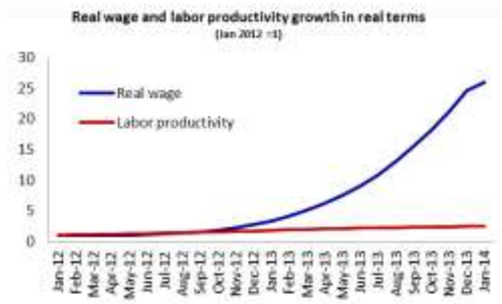
Inflation remained stubbornly high during 2013. Inflation remained at 16.5% (e.o.p) and was fuelled by credit and real-wage growth, accelerating currency depreciation and tariff increases for utilities and transport services. Strong banking credit growth (10.3%, y/y, in real terms) – which is the primary monetary transmission channel in Belarus – was tempered only in November, when the monetary authorities imposed a monthly limit of 0.7% on nominal credit growth. While this limit is supposed to remain in place during 2014, it was breached both in January and February (when credit expanded by 1 and 1.7%, respectively). While the refinancing rate has remained at 23.3% since June last year, the NBRB cut the interest rate for liquidity support from 33 to 30% since the beginning of the year, easing liquidity constraints in the economy, but undermining monetary tightening.

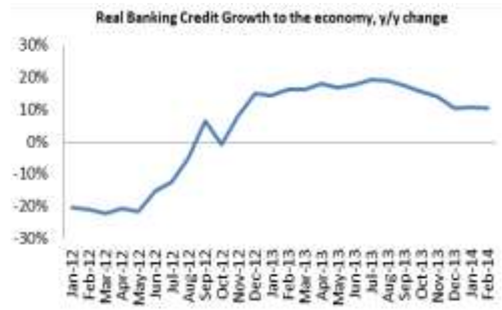
While the government budget achieved a small surplus, recapitalization of state-owned banks weakened the fiscal position. While the economic slowdown resulted in shortfalls in profit tax revenues and customs duties, this was offset by growth in VAT and excise tax revenues, fuelled by domestic consumption growth, inflation and excise rate increases. While the General Government recorded a small surplus (0.2% of GDP), below the line recapitalization of State-owned Banks, including of the Development Bank (0.6% of GDP), implied a shallow deficit for the amended government balance.

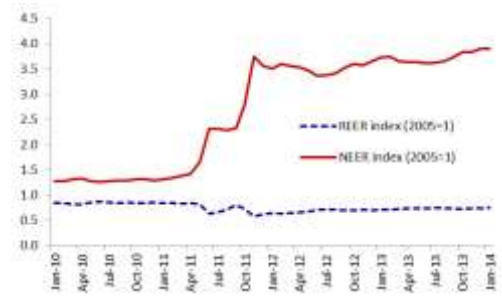
At the same time, Belarus is facing large and unsustainable external imbalances. During 2013, the current account deficit widened to -10.2% of GDP (compared to -2.9% of GDP in 2012). After exceptionally strong performance during 2012, merchandise exports declined sharply by 19.8%, dragged down by weak external demand, rising labor unit costs driven by real wage growth (15.8%) in excess of labor productivity growth (2.2%), an appreciating real effective exchange rate (7.3% y/y) and negative terms of trade developments including a sharp decline of the price of potassium. Imports also fell, but at a much slower rate than exports, expanding the merchandise trade deficit to -6.4% of GDP (compared to 0.9% surplus in 2012). This together with a deficit on secondary income (-3.6% of GDP) – largely because of transfers of export duties on refined oil to the Russian budget – resulted in balance of payment pressures which were amplified by large external debt repayment needs and limited access to external financing. Pressure on the exchange rate intensified, triggering a gradual, but accelerating nominal depreciation during the second half of the year. Meanwhile, reserves (excluding monetary gold) – which were low to begin with – fell further to a critically low level of less than 1.4 months of import cover by the end of the year.











Source: World Bank Staff Estimates, based on official statistics.

Medium-term Outlook

The economic outlook for Belarus remains challenging with economic growth expected to decelerate further during 2014. We project a shallow contraction of -0.5% for 2014 due to the continued weakness of the Russian economy and the need for domestic demand adjustment to correct existing imbalances. The slowdown will dampen fiscal revenues and while there is a strong record of prudent management of the headline fiscal deficit, a small budget deficit is projected to emerge this year. We expect inflation to remain at least 15% (eop), if planned tariff increases are implemented and the exchange rate continues to adjust. On the external side, while imbalances will remain, the recent trend of slowing import growth is expected to continue. Faster exchange rate depreciation should at the same time contain further declines in exports. The resulting improvement of the trade balance will ease pressures slightly on the current account, which is projected to narrow to 8.4% of GDP. Despite external adjustment, gross financing needs will remain substantial with another US$ 2.5 billion debt repayment scheduled for this year. Uncertainties over external financing sources, including FDI inflows and access to additional external debt, both market lending and official sources, reinforce BOP pressures and are likely to keep reserves at low levels. Over the medium term, we expect a timid recovery in growth, driven largely by improved external conditions with Russia expected to resume higher growth during 2015 and 2016. For 2015, we assume some loosening of macroeconomic policies ahead of the elections. However, despite this we anticipate external imbalances to persist, unless decisive reforms are undertaken quickly to address the structural roots of declining competitiveness of the Belarusian economy.

The outlook is subject to significant downside risks. On the domestic front, intensifying pressures ahead of the 2015 elections may make it more difficult for the authorities to pursue stabilization-oriented macroeconomic policies. While looser macroeconomic policies – especially high wage and credit growth – would increase growth, they will amplify existing imbalances and require a sharper and more painful adjustment similar to that during the 2010-2011 crisis. On the external front, heightened political risks associated with ongoing tensions between Russia and Ukraine could weigh on the Belarusian economy through its impact on Russian economy.

Mitigating these risks will require sustained tightening of macroeconomic policies, even if this comes at the expense of short-term economic growth. Little can be done by Belarus about the weak external environment which will continue to constrain demand for its exports. To avoid a further deterioration of the external position, policies should aim to contain domestic demand and hence import growth – including through further tightening of credit to the economy and wage moderation which should not exceed labor productivity growth. For growth to become less reliant on domestic demand stimulus, reforms should aim to reduce cost pressures, improve capacity to innovate, sustain human capital, create more efficient institutions and reduce state interventions and red tape to stimulate private sector growth. Imposing market discipline and incentives on the state-owned sector while reducing state support and implementing a gradual, but consistent and transparent privatization program would help unlock productivity growth and strengthen competitiveness (see also the special topic note on external competitiveness). These measures should be accompanied by social safety measures to protect the vulnerable from potential negative impacts of these reforms, including policies to support a more dynamic labor market.

Medium Term Macroeconomic Outlook

		Estimate		Projection	
	2012	2013	2014	2015	2016
Nominal GDP, BRB billion	530356	636784	734976	850441	1004966
Real GDP,% growth	1.7	0.9	-0.5	1.5	1.0
Consumption,% growth	8.2	14.9	-0.2	3.5	-1.7
Investment,% growth	-9.8	7.5	-16.1	-3.7	-14.4
CPI,% e.o.p growth	21.8	16.5	16.4	16.5	15.9
Export of Goods and Services,% growth	10.1	-19.2	2.7	1.2	4.1
Import of Goods and Services,% growth	11.2	-8.2	-3.5	1.7	-4.1
Current Account Balance,% GDP	-2.9	-10.2	-8.4	-9.8	-7.6
General Government Revenues,% GDP	40.7	41.9	40.8	40.4	40.9
General Government Expenditures,% GDP	40.0	41.7	41.8	41.6	42.4
General Government Balance,% GDP	0.7	0.2	-1.0	-1.2	-1.6
External debt,% GDP	53.2	54.8	62.9	61.7	78.2
PPG debt,% GDP	31.5	31.3	27.7	27.1	29.4

Source: World Bank Staff Estimates.

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