



- **The authorities are tightening monetary and fiscal policies to stem the decline of the ruble and further drawdowns of foreign exchange reserves.**
- **Economic activity is likely to contract in 2015 and in 2016 due to weak external demand and low oil prices, while external financing will remain a concern.**
- **The current economic challenges and domestic structural constraints reinforce the need for comprehensive economic transformation.**

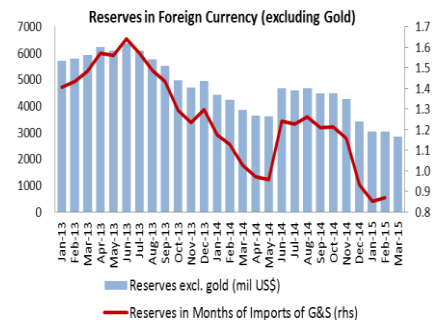
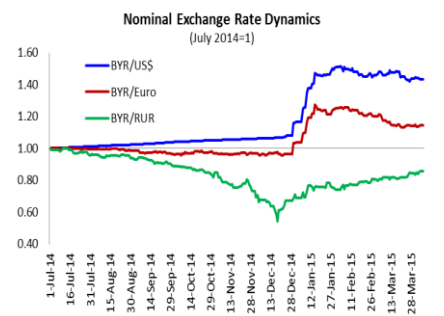
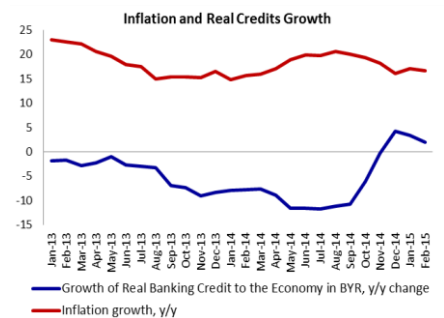
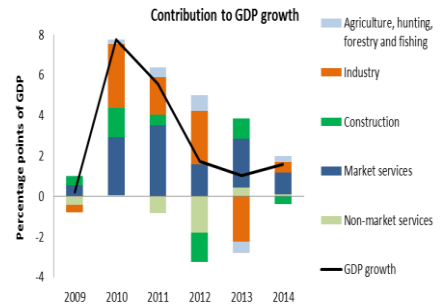
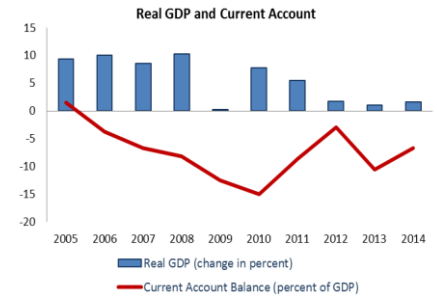
Recent Economic Developments

Weaker external demand from Russia and Ukraine, the country's key trading partners, has depressed output in early 2015. After a 1.6 percent growth in 2014 as a whole, real GDP fell by 2 percent from a year earlier in January-March 2015. On the production side, the decline was due to contraction of industrial output by 7.3 percent, after demand from traditional export markets fell sharply, that more than offset increases in construction, agriculture and retail trade. All sectors of industry fell, except for the chemical, petrochemical, and pharmaceutical industry. In sub-sectors of machine-building and light industries, the stock of unsold goods exceeded two months of output.

Inflation has remained high, with exchange rate depreciation more than offsetting the effect of lower import prices for oil and natural gas. Twelve-month consumer prices rose 16.2 percent in March, with the highest upward trend in utilities (29.0 percent), transport (19.6 percent) and food (16.7 percent). In late 2014, a rapid weakening of the Russian Ruble put pressure on the Belarusian Ruble (BYR), while heightened depreciation expectations triggered additional demand for foreign exchange. Between December 2014 and February 2015, the BYR fell 38 percent against the US dollar. After short-lived, ineffective administrative measures introduced in December 2014 and abolished in January 2015, the National Bank announced a policy shift towards inflation targeting. The National Bank's target band for 12-month inflation for 2015 is 18±2 percent. This is to be achieved through monetary targeting. The National Bank increased its main policy rate by 500 basis points to 25 percent from January 9, 2015.

The trade balance improved, but foreign exchange reserves declined due to large external debt repayments. In January-February 2015, merchandise exports contracted by 29.4 percent from a year earlier in dollar terms, while imports dropped by a much larger 36.1 percent. As a result, the trade balance in goods and services turned positive (\$0.7 billion). Merchandise exports to the CIS, including Russia, declined by 40.5 percent, reflecting weak demand for manufactured goods. Exports to the non-CIS decreased by 16.2 percent y/y, including to the EU by 23.3 percent, mainly due to lower prices of oil products, the key exports item. In January-February, the government paid \$0.16 billion of its foreign debt. In March, the government paid the last tranche (\$75.9 million) to the IMF. Meanwhile, outstanding external public debt payments for 2015 remain substantial, including to Russia (\$0.7 billion), EurAsEc Anti-Crisis Fund (\$0.5 billion), and on Eurobonds (\$1.2 billion). By end-March 2015, foreign exchange reserves (excluding monetary gold) declined further to \$2.86 billion, the lowest level for the last three years. This is equivalent to less than a month of imports of goods and services.

Despite the weaker economy, the Government managed to keep fiscal policy prudent. In January-February 2015, the officially reported general government was in a surplus of 0.7 percent of GDP (up from 0.2 percent of GDP a year ago), excluding off-budget items. Despite declining revenues from indirect taxes, including from VAT (down 0.8 percent y/y) and excise taxes (down 18.4 percent y/y), corporate income tax and foreign trade tax revenues recorded significant increase, due to higher potash export revenues (explained by a low base effect and higher export prices) and additional earnings linked to foreign exchange (resulting from the nominal depreciation of the BYR). These allowed total real revenues to grow by 10.6 percent, while expenditures were almost flat in real terms (increased by 0.9 percent). The Government is preparing amendments to the adopted 2015 budget to align it with a revised macroeconomic framework.



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

Medium-term Outlook

Real GDP is likely to decline in 2015 and 2016 due to weak external demand and subdued oil prices. Russia's economy is set to contract by 3.8 percent in 2015 and output is likely to be much weaker in Ukraine. At the same time, policies to stimulate domestic demand in Belarus – the main source of growth in past years – appear to have run their course. With refined oil accounting for one sixth of industrial output and for more than a third of Belarus's exports, low oil prices will affect the external accounts, fiscal revenues, and, as a result, growth. On balance, we project real GDP in Belarus to decline by 3.5 percent in 2015 and by 1 percent in 2016. Because of prevailing inflation expectations and planned increases in utility tariffs, inflation will likely stay in double-digits through 2016. Although Belarus will retain oil customs duties from 2015 onwards under a new energy trade agreement with Russia, shortfalls in export revenues, external debt repayment needs (about \$3.8 billion in 2015 and \$1.7 billion in 2016), and limited access to external liquidity will exacerbate balance of payment pressures. The weakening economy will put pressure on real wages and together with returning migrants from Russia may lead to higher unemployment. This could pose poverty risks. The optimal policy response to such risks is scaling up transparent and well targeted social safety nets while advancing structural reforms to boost the economy's productive potential.

Comprehensive, coherent, and credible (the three “C”s) structural transformation policies would allow the economy to adjust more quickly to the changing environment and to return to strong growth. While essential, macroeconomic stabilization alone will not be sufficient to reinvigorate growth. Without structural reforms, existing imbalances and vulnerabilities are likely to intensify. The reform agenda may aim at: (1) enhancing macroeconomic stability as a precondition for a sustainable growth; (2) creating efficient financial markets to improve the allocation of capital; (3) facilitating a dynamic labor market, which allows labor to be reallocated efficiently to higher productivity sectors, and putting in place robust social safety nets; (4) transforming the state-owned sector to reduce losses and enhance the incentives for efficiency improvements; (5) supporting private sector growth and job creation through investment climate reforms; and (6) enhancing efficiency of product and service markets.

Selected measures to improve growth potential can be implemented in 2015-2016. These include adoption of a time-bound plan to reduce the resources allocated for various channels of state support, with specific, numerical annual targets; enactment of corporate governance legislation to strengthen institutional framework for SOE management; privatization of small- and medium-sized state-owned companies; piloting case-by-case restructuring of several larger SOEs; instituting support mechanisms for private SME, and eventual shift to market-based price determination. If implemented consistently, these measures would facilitate enterprise restructuring and exit of less efficient companies, while promoting entry of new firms. Together with the shift in the growth model toward more economic efficiency and market orientation, social protection and labor market policies will also have to shift away from protecting unproductive jobs to protecting workers and their ability to earn income. This will require designing and implementing new mechanisms to support the unemployed during their transition to new jobs. The **Special Topic Note** explains why it is important to have robust social safety nets and outlines policy recommendations.

Key Macroeconomic Indicators

| | 2013 | 2014 | 2015f | 2016f | 2017f |
|---|-------|-------|-------|-------|-------|
| Nominal GDP, BYR trillion | 649.1 | 778.5 | 728.6 | 856.5 | 998.7 |
| Real GDP, % change | 1.0 | 1.6 | -3.5 | -1.0 | 2.0 |
| Real Private Consumption, % change | 10.8 | 4.5 | -4.8 | -1.4 | 2.5 |
| Real Government Consumption, % change | -2.1 | -1.9 | -2.5 | -0.5 | 0.0 |
| Real Gross Fixed Investment, % change | 9.6 | -8.9 | -10.8 | -1.8 | 2.8 |
| Export of Goods and Services, % real change | -16.0 | 5.3 | -7.0 | -2.0 | 2.0 |
| Import of Goods and Services, % real change | -4.2 | 2.4 | -9.0 | -3.0 | 2.5 |
| GDP deflator, % change | 19.0 | 18.0 | 18.7 | 16.7 | 14.3 |
| End-period CPI, % change | 16.5 | 16.2 | 18.8 | 16.4 | 14.7 |
| Exchange rate (BYR /\$, average) | 8875 | 10215 | .. | .. | .. |
| Broad Money to GDP, % | 29.8 | 30.8 | .. | .. | .. |
| Current Account Balance, % GDP | -10.5 | -6.7 | -4.4 | -4.9 | -5.2 |
| Terms of Trade, % change | 0.8 | -3.1 | 4.2 | 1.8 | -1.4 |
| General Government Revenues, % GDP | 40.3 | 40.3 | 39.3 | 39.5 | 39.9 |
| General Government Expenditures, % GDP 1/ | 40.2 | 39.2 | 39.9 | 39.6 | 39.7 |
| General Government Balance, % GDP | 0.1 | 1.1 | -0.6 | -0.1 | 0.2 |

Source: Belarusian authorities and World Bank staff estimates and projections.

1/ net of extra-budgetary expenditures.

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