WORLD BANK GROUP

BELARUS Economic Update

June 5, 2019

- ***Weak productivity and repercussions of deteriorated external environment are holding back economic growth in Belarus.***
- ***Potential growth to remain low unless higher productivity strengthens competitiveness.***
- ***To raise living standards, policies need to increase worker productivity, with strengthened social assistance systems protecting the vulnerable groups and supporting labor reallocation.***

Recent Economic Developments

Slowing economic recovery over the last fourteen months reflects worsening external conditions. While real GDP growth reached 3 percent in 2018, the pace of growth has slowed down to just 1.1 percent in Q1 2019, and then to 1.4 percent in Jan-April 2019 y/y. Over Jan-March 2019, merchandize exports (in US$ terms) declined by 3.2 percent, in contrast to almost 16-percent growth y/y in 2018 on the back of higher commodity prices. Weaknesses in external sectors, due to stagnating traditional markets, have been partially offset by stronger domestic demand. Real investments grew over 2017-2018, supported by increases in real capital expenditures of the consolidated budget as well as household consumption, driven by real wage and income growth for nine quarters in a row.

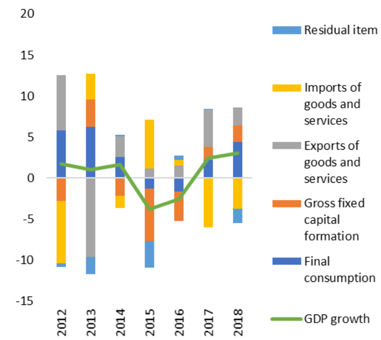
On the supply side, the broad-based sectoral recovery of 2017-2018 dissipated by the early 2019. In 2018, output of all main sectors, except agriculture, grew. During Q1 2019, only several manufacturing industries recorded output growth above 7 percent p.a., while in the majority of sectors it remained close to 1 percent y/y, or even turned negative. Export-oriented industries – and particularly agro-food producers, such as meat and dairy products – continued to be exposed to trade tensions with Russia, their main market.

The current account deficit has remained mostly flat at 0.4 percent of GDP in 2018. Exchange rate flexibility has been retained, while the foreign exchange market has been further liberalized in 2018, including abolishment of surrender requirements for exporters. In the second half of 2018, adjustment of the Russian Ruble led to a slight weakening of the Belarusian currency vis-à-vis US$, resulting in 8.7 percent annual nominal depreciation. However, in the first five month of 2019, this tendency reversed, and the BYN appreciated against the US$ by 3.7 percent y/y in nominal terms. Gross international reserves amounted to US$7.2 billion by April 2019, covering more than two months of goods and services imports. Both net foreign direct investment (FDI) and annual remittance inflows remained close to their historical averages. In 2018, net FDI reached 2.3 percent of GDP, while remittances – 2 percent of GDP (or US$1.2 billion), as estimated by the World Bank's latest Migration and Development Brief (April 2019).

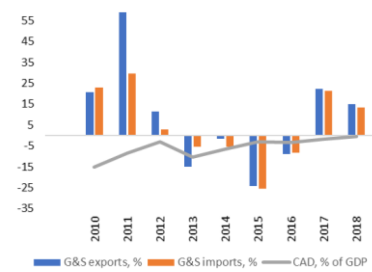
Consolidated government revenues recorded real growth due to higher real tax revenues. To meet public debt service payments, reaching 1.9 percent of GDP in 2018 (almost doubling from 2013), budget transfers were reduced, to generate a headline fiscal surplus of 3.8 percent of GDP, net of quasi-fiscal expenditures. However, public debt pressures remain, as the government debt to GDP ratio – which includes direct and guaranteed debt of central and local authorities – amounted to 45.7 percent by the beginning of 2019.

Quantitative targeting framework is keeping inflation at historically low levels—5.6 percent y/y in December 2018, and 5.5 percent y/y in April 2019, against the annual target not higher than 6 percent. As the policy rate remained virtually unchanged throughout 2018, credit to the economy grew – by 10 percent p.a., and especially to households – by 28.2 percent in nominal terms.

Contribution to Real GDP Growth, %

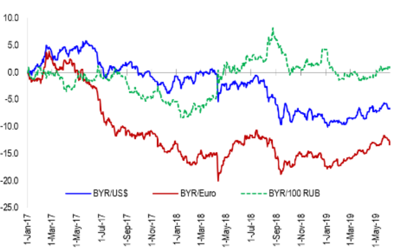


% Change of Exports and Imports (in nominal US$) and Current Account Deficit

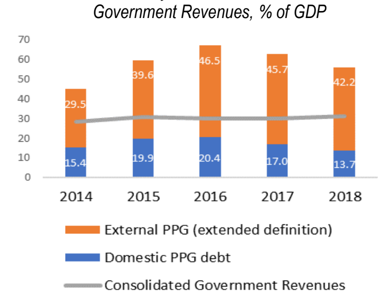


Index of Nominal Exchange Rates

percent of nominal depreciation compared to January 1, 2017



Public and Publicly Guaranteed Debt and General Government Revenues, % of GDP



Medium-term Outlook

The macroeconomic outlook for 2019 and over the medium term remains weak. Economic growth is expected at below 2 percent p.a., suppressed by a combination of domestic structural rigidities and deteriorating terms of trade, under escalating bilateral economic tensions with Russia, where the economy's growth will be sharply lower than expected. Even this modest outlook is conditional upon partial compensation – at least one half of the expected losses – from the 'tax maneuver' in Russia, which implies a loss of export duties on oil products currently collected by Belarus's budget and rise in input prices for domestic oil refineries. With no compensation, growth could decelerate further due to possible output adjustment in the petrochemical sector, while the revenue loss could eventually be balanced by additional fiscal tightening required to meet debt repayment obligations, with negative repercussions on economic growth.

Rapidly rising public debt, largely denominated in foreign currency, and the uncertainty about negative spillovers from Russia's new energy taxation, along with deteriorating trade relations, pose significant risks to economic growth. The room for policy flexibility is limited, as monetary policy efficiency is compromised by high dollarization and subsequent weak monetary transmission mechanism, while exchange rate adjustment remains risky due to high share of foreign currency-denominated public debt. Fiscal policy, the remaining policy tool, has a limited scope due to high levels of contingent liabilities and quasi-fiscal operations related to state-owned enterprises (SOEs) and state-owned commercial banks, and high tax expenditures against weak net borrowing capacity.

One of the main challenges is to strengthen competitiveness and accelerate export diversification. The current export profile makes the Belarus's economy vulnerable to external shocks arising from bilateral trade disputes and commodity price fluctuations. While the ongoing trade disputes may well be resolved, Russia's reliance on imports from Belarus has been gradually decreasing due to import-substitution policies, especially in agriculture and food processing, with expectations for self-sufficiency over the medium-term. In manufacturing, the situation may also be still challenging due to intensified competition in the Russian market from the global players. At the same time, Belarus scores relatively low – 103 out of 160 – in World Bank's Trade Logistics Performance Index, doing poorly on customs, international shipments, and tracking and tracing. These constraints need to be addressed, including through improvements in the regulatory environment supported by further ease of doing business and operational restructuring of domestic businesses, as export success and diversification requires moving into new markets with new products.

Growth prospects depend on implementation of policies for greater economic efficiency. On the positive side, recent measures to liberalize economic activity and growing exports of ICT services, should contribute to stronger foreign trade. However, inefficiency and contingent liabilities in SOEs continue to undermine economic activity. SOEs continue to crowd out more productive use of capital and remain a key source of fiscal risks. Advancing SOEs restructuring is needed to create more space for the development of the private sector, as growth of small- and medium-sized companies could hit a 'glass ceiling' if resources remain captured in other, less productive uses. To cushion the impact of enterprise restructuring on vulnerable groups, social safety nets need to be reoriented towards unemployment benefits and means-tested support, such as the monthly cash assistance (GASP) program and the Household Utility Subsidy (HUS) program. The *Special Topic Note* discusses the ways to enhance social assistance mechanisms to prevent rise in poverty and support vulnerable social groups.

Key Macroeconomic Indicators

	2016	2017	2018	2019f	2020f	2021f
GDP growth, at constant market prices	-2.5	2.5	3.0	1.8	1.3	1.2
Private Consumption	-3.2	4.8	8.3	3.5	2.5	2.0
Government Consumption	0.3	-0.9	-1.0	1.7	1.5	0.5
Gross Fixed Capital Investment	-14.5	5.5	4.9	-1.6	2.9	-3.0
Exports, Goods and Services	2.6	7.5	3.5	2.4	2.6	2.6
Imports, Goods and Services	-1.4	11.1	6.9	3.2	1.4	0.2
Current Account Balance, % of GDP	-3.5	-1.7	-0.4	-2.1	-3.0	-2.7
Fiscal Balance, % of GDP (net of quasi-fiscal expenditures)	1.3	2.8	3.8	2.0	-0.1	1.3
Consolidated Government Debt, % of GDP*	52.8	52.3	46.7	45.7	46.6	46.9
Poverty rate ($5.5 a day in 2011 PPP terms)	0.7	0.8	0.7	0.7	0.7	0.7

** includes debt of central and local authorities, both direct and guaranteed.*

Source: Belarusian authorities and World Bank staff projections. Annual percentage change, unless otherwise noted; f=forecast

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