BELARUSIAN MACROECONOMIC FORECAST

No. 1(6), June 2013

The Price of Growth Stimulation – Increasing External Imbalances

Executive summary

GDP: Recent gains in external price competitiveness have been exhausted during 2012. Furthermore, an active wage policy in 2012 brought real unit labor cost up to its medium term level. Hence, there is no more room to increase real wages without a corresponding deterioration in net exports. Thus, we expect a steady deterioration in net exports in 2013 and 2014. Alongside, real wages will grow by 9.4% in 2013, but afterwards their growth is going to weaken considerably causing the same trend in household consumption. Against this background, capital investments are going to become the engine of growth. However, this policy is unable to guarantee a steady pace of growth, along with increasing external imbalances. In 2013, we expect GDP to grow by 3.8% and by 2.5% in 2014.

Monetary environment: The current equilibrium observed in financial markets is rather fragile. However, the authorities seem to ease monetary policy along with the attempt to provide a more or less stable nominal exchange rate. This policy will be successful only in case of adequate amount of external borrowings. If that is the case, we expect the nominal exchange rate to be USD/BYR 9200 and 9500 by the end of 2013 and 2014, correspondingly, although the depreciation might be much more severe in case external financing cannot be identified. We expect 17.8% and 9.6% of average annual inflation for 2013 and 2014, correspondingly.

Public finances: We expect a softening of fiscal policy in 2013–2014, as the government will increase capital expenditures to finance investments, run under the motto of modernization. Furthermore, we expect an increase of expenditures on wages and public purchases in 2013. However, the consolidated budget deficit will be moderate (0.6 and 1.8% of GDP in 2013 and 2014 respectively), as growing expenditures are partly offset by increased VAT and excises revenues.

Balance of payments: In 2013, the current account deficit will be around USD 5 bn, or 7.1% of GDP, and will rise in comparison to the previous year as a result of exports declining steeper than imports. Exports will slide due to sharp contraction in solvents trade with non-CIS countries, and reduction in supply of petroleum products to these countries. Imports will shrink due to Russia's cutback in petroleum products supply. In 2014 the current account deficit will expand to USD 7.6 bn or 9.9% of GDP. We forecast that FDI inflows will be around USD 1.5 bn in both 2013 and 2014.

Key forecast figures

	2010	2011	2012	2013F	2014F
Real GDP, % yoy	7.7	5.4	1.5	3.8	2.5
Consolidated budget balance, % of GDP*	-2.6	2.1	0.5	-0.6	-1.8
Current account balance, % of GDP**	-15.0	-11.2	-2.9	-7.1	-9.9
CPI, % yoy (aop)	7.7	52.3	59.2	17.8	9.6
Gross external debt, % of GDP**	52.5	74.2	61.3	55.8	61.0

* Social Security Fund is not included.
**Based on the average annual exchange rate in 2011 (5984 USD/BYR).
Sources: National Statistical Committee, NBB, Minfin, GET forecasts

Forecast calculations were completed in May 2013. Next revision is scheduled for December 2013.

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MACROECONOMY

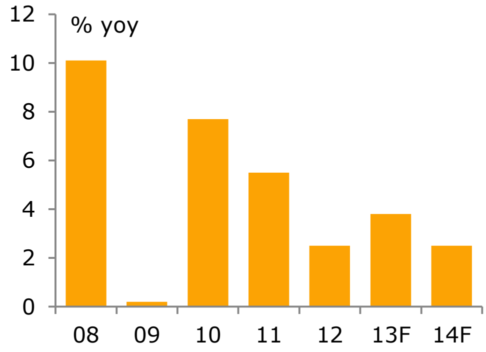
A return to the pre-crisis growth regime

The export of thinners and solvents in the first half of 2012 was a temporary positive shock for the Belarusian economy, as it contributed to GDP growth considerably (both directly as well as through positive externalities for other industries). Furthermore, a jump in productivity allowed increases in real wages, which nevertheless did not hurt external price competitiveness (real unit labour costs were almost unchanged during the first half). During the second half of 2012, the growth regime was shifted towards domestic demand. Major characteristics of this period were pretty much similar to the pre-crisis growth regime, i.e. the government pushed growth through stimulation of domestic demand, while growing external imbalances were the other side of the coin. It should be stressed that the contribution of domestic demand components to GDP growth was not uniform. Household consumption was the leading one against the background of wage stimulation policy carried out by the government. However, this kind of expansionary policy may be somehow justified. First, it was supposed to prevent social tensions associated with the sharp fall of real incomes in 2011. Second, the economy was still in the phase of cyclical slowdown, which is a traditional argument for government interventions. Gross capital formation, in turn, performed downward dynamics. A high degree of uncertainty, high and volatile inflation expectations, and correspondingly extremely high real interest rates were behind this trend.

From a medium-term perspective, the outcomes of the policies in the second half of 2012 may be interpreted as exhausting specific (i.e. post crisis) gains in price competitiveness, as real unit labour cost grew dramatically during the second half. The real effective exchange rate had already appreciated by roughly 15% during the first half of 2012, while in the second half it was almost constant. This means that there are no perspectives for further drastic increase in exports (which was the engine of growth between 2011H2-2012H1) due to price factors. In other words, the majority of Belarusian goods returned to price levels where they competed before the 2011 crisis, a period, however, which is associated with a lack of competitiveness. Moreover in 2013, due to the absence of thinners and solvents in the exports basket, the results of the trade in energy goods will be much worse than a year before as well. The latter will result in a reduction of exports to countries other than Russia. So, herewith we expect a reduction of exports in real terms by roughly 18%. As for exports to Russia, we expect them to stagnate, given poor growth in that country. Less energy exports correspondingly means less energy imports. So, we expect a reduction of imports from Russia in real terms by roughly 25%. However, imports from other countries are going to increase (mainly consumer and capital goods) at the background of increasing disposable income and an appreciating real exchange rate. Hence, we expect that in 2013 the contribution of net exports will be negative at a level of 2.2 percentage points of GDP.

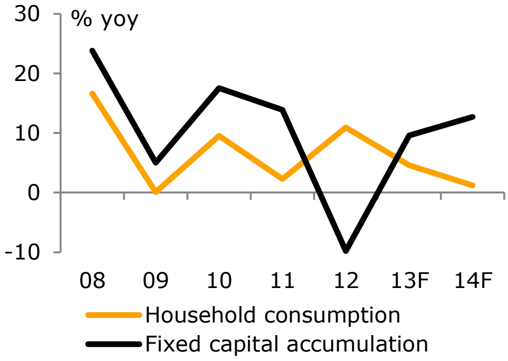
The government seems to keep on targeting output growth and for this to stimulate domestic demand. However, a major distinction in comparison to 2012H2 is that household consumption is going to pass the baton of 'growth engine' to gross capital formation. Having increased real unit labour cost up to its medium-term trend, the government cannot provide further growth of wages at the expense of deterioration in firms' price competitiveness. Through this, we expect that in 2013 real wages will grow by 9.4%, which will lead to rather modest growth of household consumption (4.6%). At the same time,

Real GDP growth



Source: National Statistical Committee, GET forecasts 2013–2014.

Household consumption and fixed capital accumulation



Source: National Statistical Committee, GET forecasts 2013–2014.

Contributions to GDP Growth

	2012	2013F	2014F
GDP	**1.5**	**3.8**	**2.5**
Household consumption	5.9	2.7	0.7
Gross fixed capital formation	-4.1	3.6	5.0
Net exports	-1.8	-2.2	-4.4
Other components+ statistical discrepancy	1.5	-0.3	1.2

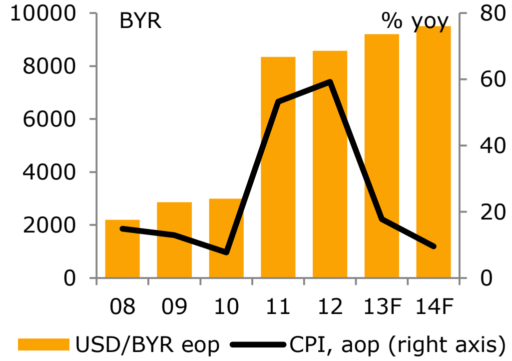
Note. Contribution to growth – in percentage points of GDP.

Source: 2012 – National Statistical Committee, GET forecasts 2013–2014.

the campaign of modernization and correspondent mobilization of funding sources seems to spur the growth of capital investments. This does not mean that the problem of a lack of the investment finance has been solved. However, active stimulation of bank credit by the government and their pressure on enterprises to provide investment finance seem to mitigate this problem for a while. We expect that in 2013 banks loans and consolidated budget funds will be the core funding sources for capital investments. Through this, we expect gross capital formation to grow by 9.6% in 2013, contributing 3.6 percentage points to GDP growth. Finally, we expect that GDP in 2013 will grow by 3.8%.

In 2014, the major trends in economic development will be roughly the same. However, according to our forecast, two major challenges are to become much more evident. First, the economy is going to return to a huge external imbalance (unless it will be mitigated through exchange rate and/or austerity policy). For 2014, we expect further deterioration of net exports, and its contribution to GDP growth to be negative (4.4 percentage points). Second, we expect only a slight growth in real wages due to nominal and real constraints (3.2% yoy). Under this scenario, the growth of household consumption will be modest again (roughly 1.2% yoy), while gross capital formation will still be the main growth contributor (we expect growth by 12.7%, which means 5.0 percentage points of contribution to GDP growth). Finally, we expect GDP growth of 2.5% in 2014. However, accepting an environment of lower growth is not the only problem for policy makers. Even this modest growth is going to be associated with the development path similar to the period of 2005-2010, which means increasing external imbalances, which sooner or later threaten macroeconomic stability.

Exchange rate and prices



Source: NBB, GET estimates 2013–2014.

MONETARY ENVIRONMENT

High degree of uncertainty is maintained

In late 2012 and the beginning of 2013, the monetary environment seems to have improved: households and legal entities make new savings mainly in Belarusian rubles, and the credit market shows signs of recovery. However, certain actions of the monetary authorities to push credit activity are of concern, as it may disrupt the fragile equilibrium in financial markets. The extent of the sustainability of the latter depends on consumer confidence, their trust in monetary authorities, which finally manifests itself in inflation expectations and their sensitivity to external shocks. According to our vision, there are still reasons to claim that the current equilibrium in financial markets is fragile, which means that an expansionary monetary policy along with the direct stimulation of the credit market is dangerous in terms of macroeconomic stability.

However, we see signs that the monetary authorities lean towards a gradual easing of monetary policy, coupled with the wish to guarantee a more or less stable nominal exchange rate. If that is the case, attracting the needed amount of external borrowings is going to become a key policy agenda question for 2013, and especially for 2014. If this problem is solved successfully, we expect more or less stable dynamics of the nominal exchange rate: USD/BYR 9200 and 9500 by the end of 2013 and 2014 correspondingly (although depreciation might be much more significant in case external financing will not be found). Under this scenario, we expect 17.8% and 9.6% average annual inflation for 2013 and 2014.

PUBLIC FINANCES

Fiscal policy loosening

Fiscal policy is expected to become less tight during 2013–2014 as compared to previous years. This easing is related to the expenditure side, as the government might tend to stimulate investments by increasing public capital expenditures. Still, the consolidated budget deficit is forecast at a moderate level of 0.6 and 1.8% of GDP in 2013 and 2014, respectively.

Revenues of the consolidated budget are expected to grow up to 31.2% in 2013 and 31.1% in 2014 (30.0% of GDP in 2012). The growth is associated with increased revenues from taxes on goods and services. First, VAT revenues grow by 0.9% of GDP on the back of abolished privileges within communication services taxation and increased imports to GDP ratio. Second, the budget benefits from excises tariffs growth – the related effect is estimated at 0.4% of GDP. Other tax revenues are forecast to be largely stable. Slight decrease of profit tax is offset by positive dynamics of personal income tax revenues. Tax policy in 2014 is expected to remain unchanged, thus no serious changes in structure and volume of consolidated budget revenues is forecast.

Expenditures of consolidated budget are expected to build up to 31.8 and 32.9% of GDP in 2013 and 2014 respectively (from 29.4% of GDP in 2012). The growth is assumed to be caused by several lines of expenditures in 2013. First, expenditures on wages and related payments may grow by 0.6% of GDP due to increase of real wages in the first half of the year. Second, public purchases of goods and services are expected to increase by 0.5% of GDP as the government may use this instrument to stimulate domestic demand and compensate for shrinking external demand on investment goods. Third, public capital expenditures are forecast to amount up to 7.7% of GDP (increase of 0.8% of GDP), as the budget has to play an important role in financing investment growth in 2013. Moreover, a slow recovery of bank credit due to relatively tight monetary policy may lead to further public capital investments growth in 2014 (up to 8.6% of GDP).

BALANCE OF PAYMENTS

Current account: Increasing external imbalances

In 2012, the trade in solvents and petroleum products brought down the current account deficit to 2.9% of GDP. However, in 2013 the deficit is expected to widen sharply to around USD 5 bn (7.1% of GDP). In 2014 we forecast a further deterioration of the deficit to USD 7.6 bn, (9.9% of GDP). The negative balance of trade in goods and services as well as balance of primary and secondary income accounts are the reasons behind this trend.

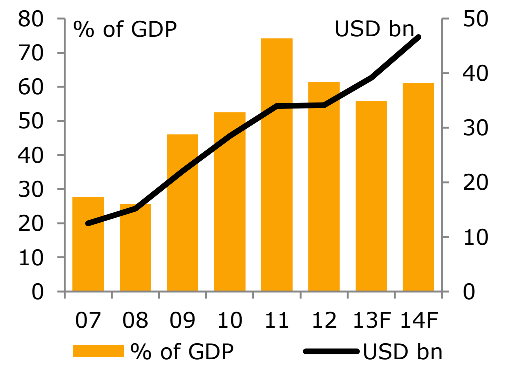
In 2013, the merchandise trade balance will return to its long term trend of a persistent deficit. Exports will drop by 16.7%, yoy mainly due to a sharp contraction in diluting agents and solvents trade with non-CIS countries, and a reduction in supply of petroleum products to these countries. In addition, shrinking demand on the Russian market will likely put downward pressures on sales of Belarusians machines and equipment (including products of automotive industry) which, in turn, will negatively influence exports. Imports will also decrease in 2013, owing to sharp contraction in supply of oil refinery products from Russia, which blocked Belarus' solvent export scheme. At the same time we forecast that imports will drop much less than exports because of increase in consumer goods' imports due to expansion of private consumption. We also expects that imports of capital goods and

Fiscal indicators, % of GDP

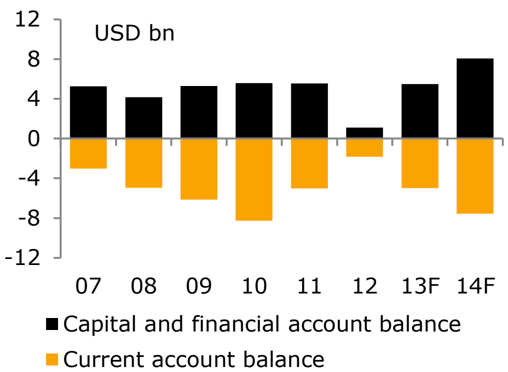
	2012	2013F	2014F
Consolidated revenues	30.0	31.2	31.1
Consolidated expenditures	29.4	31.8	32.9
Consolidated budget balance	0.5	-0.6	-1.8

Source: Ministry of Finance, GET forecasts 2013–2014.

Source: National Statistical Committee, GET forecasts 2013–2014.



Source: NBB, GET forecasts 2013–2014.



Source: NBB, GET forecasts 2013–2014.

machinery will swing up owing to the improved investments and a higher demand for manufacturing equipment by Belarusian producers supported by government plans to modernize the national economy. Under this condition, balance of merchandise trade will be negative in 2013 and account for USD 2.8 bn. In 2014, the deficit of merchandise trade will tend to expand further and is expected to be at around USD 5.4 bn in consequence of exports' contraction against imports growth.

In 2013 and 2014, the balance of trade in services will be positive at around USD 2.5 bn and USD 2.6 bn respectively. Oil and gas transit and transportation services will support growth in exports. The main contribution to imports growth will traditionally come from expansion of transportation, travel, and construction services. We expect that the balance of trade in goods and services in 2013 will be negative and reach USD 284.5 m (0.4 % GDP). In 2014 it is forecast to be negative and to widen drastically to USD 2.9 bn (3.7% of GDP).

We expect that the balance of primary income will be negative in 2013 and 2014 as a consequence of the increase of interest payable under general government (including interest payment on the IMF loan and Eurobonds) and non-financial sector obligations, including payment on the loans of banking and nonfinancial sectors, and income payments on FDI. The balance of secondary income will be negative in 2013 and 2014 as well because of the transfer of export duties on Belarusian oil refinery products to the Russian budget. The transfer of these duties will significantly exceed the inflow of customs duties accrued according to the agreement between Russian, Belarus and Kazakhstan on distribution of import customs duties within the Customs Union.

Capital and financial account: Repayment of debt

We expect that in 2013 and 2014 the net FDI inflow will be only USD 1.5 bn each year. The FDI inflow will be attributed to reinvested earnings and acquisition of equity capital in industry, banking and service sectors. In 2013 and 2014 the necessity of repayment of the debt under previously attracted loans (including IMF loan) will influence the balance of the other investment account, and will raise liabilities to non-residents as a result of foreign loans and credits attraction.

We forecast the inflow of portfolio investments in 2013 and in 2014. These investments may reach USD 0.6 bn in each year due to planned Eurobonds issue.

Annex. Tables

		2010	2011	2012	2013F	2014F
Table 1. GDP						
Nominal GDP	BYR bn	164 476	297 158	527 385	624 028	693 030
	USD bn**	55.2	49.7	63.3	70.2	76.4
Real GDP	% yoy	7.7	5.5	1.5	3.8	2.5
Household consumption	% yoy	9.5	2.3	10.9	4.6	1.2
Public consumption	% yoy	3.1	-3.6	-1.2	1.9	0.2
Gross capital formation	% yoy	17.5	13.9	-9.8	9.6	12.7
Exports	% yoy	2.8	29.5	11.1	-11.6	1.7
Imports	% yoy	8.3	17.4	12.1	-7.0	7.9
Table 2. Fiscal Indicators*						
Consolidated budget revenues	BYR bn	48 754	85 608	157 955	194 407	215 859
	% of GDP	29.7	28.8	30.0	31.2	31.1
EPT revenues	BYR bn	5 580	8 689	19 535	20 842	22 561
	% of GDP	3.4	2.9	3.7	3.3	3.3
VAT revenues	BYR bn	16 226	26 499	45 457	59 166	65 708
	% of GDP	9.9	8.9	8.6	9.5	9.5
PIT revenues	BYR bn	5 381	9 316	19 319	24 898	28 177
	% of GDP	3.3	3.1	3.7	4.0	4.1
Consolidated budget expenditures	BYR bn	52 980	79 428	155 169	198 184	228 263
	% of GDP	32.2	26.7	29.4	31.8	32.9
Current expenditures	% of GDP	24.0	21.5	22.9	24.1	24.3
Capital expenditures	% of GDP	8.3	5.1	6.5	7.7	8.6
Consolidated budget balance	% of GDP	-2.6	2.1	0.5	-0.6	-1.8
Table 3. Balance of Payments and External Debt						
Current account balance	USD bn	-8.3	-5.0	-1.8	-5.0	-7.6
	% of GDP**	-15.0	-10.1	-2.9	-7.1	-9.9
Export of goods	USD bn	24.5	40.9	45.5	37.9	37.7
Import of goods	USD bn	33.8	44.4	45.0	40.7	43.1
Balance of services	USD bn	1.8	2.3	2.4	2.5	2.6
Capital and financial account balance	USD bn	5.6	5.6	1.1	5.5	8.0
Foreign direct investments (FDI)	USD bn	1.3	3.9	1.3	1.5	1.5
Portfolio investments	USD bn	1.2	0.9	-0.2	0.6	0.6
Gross external debt	% of GDP**	52.5	74.2	61.3	55.8	61.0
Table 4. Money, Inflation and Exchange Rate						
Base money	%, yoy eop	49.5	84.1	61.6	31.2	23.3
CPI	%, yoy aop	7.7	53.2	59.2	17.8	9.6
Exchange rate, USD/BYR	eop	3 000	8 350.0	8 570	9 200.0	9 500

*- Social Security Fund is not included into consolidated budget.
** - For 2011 this indicator is calculated based on the market exchange rate (for 2011 on average – 5984 USD/BYR).
Sources: National Statistical Committee, Ministry of Finance, NBB, GET forecasts 2013–2014.

Notes:

aop	average of period	NBB	National Bank of Belarus
avg	average	p.a.	per annum
bn	billion	PIT	personal income tax
eop	end of period	VAT	value added tax
EPT	enterprise profit tax	yoy	year-on-year
m	million	ytd	year-to-date

Annex. Assumptions of the forecast

- World prices for crude oil (oil basket) will be USD 100 per barrel on average in 2013 and USD 102 per barrel on average in 2014.
- Belarus will get 23.0 m t of crude oil from Russia in 2013 and 2014 on a duty-free basis.
- Imports of oil products from Russia will not exceed 0.5 m t in 2013 and 2014.
- The prices of imported gas from Russia will be USD 168 per tcm (yearly average) in 2013 and 2014.
- In 2013 and 2014 the government will obtain USD 2.5 bn in each year in the form of privatization revenues, borrowings, etc.

About the German Economic Team Belarus (GET Belarus)

The main purpose of GET Belarus is to conduct a dialogue on economic policy issues with the government, civil society, and international organizations. Experts of German Economic Team have experience in policy advice in several transition economies, including Ukraine, Russia, and Moldova. In Belarus the IPM Research Center and the German Economic Team provide information and analytical support to the Council of Ministers, the National Bank, the Ministry of Foreign Affairs, the Ministry of Economy and other institutions involved in the process of formation and implementation of economic policy.

About the IPM Research Center

The IPM Research Center was established in 1999 within the mutual project of the Institute for Privatization and Management (Minsk, Belarus) and CASE - Center for Social and Economic Research Foundation (Warsaw, Poland). It is a member of the CASE research network, William Davidson Institute NGO Alliance, and Economic Policy Institutes Network (project of the UNDP's Regional Bureau for Europe and the CIS). The IPM Research Center actively cooperates with the German Economic Team Belarus (GET Belarus). Within this cooperation the IPM Research Center provides independent policy advice on economic issues to the different official agencies, namely to the Council of Ministers, National Bank, Ministry of Economy, Ministry of Finance and other organizations involved in the process of formation and implementation of economic policy.

The Mission of the IPM Research Center is to enhance national competitiveness through elaboration of the research-based economic policy recommendation and the promotion of professional dialogue on the urgent issues related to economic performance.

Activities

- Regular analysis of the economy of Belarus;
- Monitoring of main sectors of the economy;
- Promotion of professional dialogue between Belarusian and German experts on important issues for the economic development of Belarus.

Analytical materials

Current research products and publications of the project are available via the Internet:

http://research.by/get and www.get-belarus.de

Belarusian Monthly Economic Review (BMER)
A monthly bulletin has been published since October 2002. It provides readers with recent news on politics and economics, covering such sectors of the economy as the real sector, structural trends, the external sector, public finance, monetary policy and the banking sector.

Policy Papers
Analytical materials on specific economic issues providing policy recommendations for the government and other organisations involved in the process of formulating and implementing economic policy.

Belarus Infrastructure Monitoring
Monitoring of the current situation and the perspectives for the development of the energy, telecommunications and transport sectors in Belarus. The following sectors are monitored in detail: electricity, gas, communication and communication services, railways and roads.