

Recession in 2015 will turn into stagnation in 2016

Executive summary

GDP: We expect that in 2015 the Belarusian GDP will decrease by 3.5%. This will be a product of structural weaknesses, an adverse external environment, and tight macroeconomic policies. This new economic environment implies contracting domestic demand and improving net exports. In 2016, a quit from recession is likely, but the economy will stagnate at best. Furthermore, a new economic and social problem – unemployment – will arise on the national agenda.

Monetary environment: A new framework of monetary policy is likely to secure a gradual depreciation of the exchange rate, but without any persistent overhang. We expect that by the end of 2015 the USD/BYR exchange rate will be near 15,500 and 16,000 by the end of 2016. Annual average inflation is going to remain high in 2015 – 17.5%, while decelerating down to 11.4% in 2016. However, the fragility of financial markets will persist (due to problems with non-performing loans, a lack of international reserves, and volatile expectations), which increases the probability and magnitude of new shocks.

Public finances: The consolidated budget is expected to run a surplus of 2.0% in 2015 and 1.6% of GDP in 2016. It will be generated by the inflow of export duties on petroleum products estimated at the level of USD 1.5 and 1.7 bn, respectively. The surplus will be spent on debt service, while other public expenditures will largely contract in real terms. Expenditures on public procurement and transfers may be excluded, as the state is expected to prevent a reduction of state consumption in real terms.

Balance of payments: In 2015 the current account deficit will be around USD 1.5 bn, or 2.6 % of GDP, and will go down in comparison to the previous year due to a sharper drop in imports than in exports, and a reduction of the negative balance of secondary incomes due to export duties. In 2016, it is expected to be slightly higher in both absolute (USD 2.0 bn) and relative (3.2% of GDP) terms. We expect the FDI net inflow to shrink, given the recession, and expect it to be about USD 1.6 bn in both 2015 and 2016. We expect the capital and financial account balance to be in surplus at around USD 1.5 bn in 2015 and at USD 3.5 bn in 2016.

Key forecast figures

	2012	2013	2014	2015F	2016F
Real GDP, % yoy	1.7	1.0	1.6	-3.5	0.0
Consolidated budget balance, % of GDP*	0.5	0.2	1.0	2.0	1.6
Current account balance, % of GDP	-2.9	-10.3	-6.7	-2.6	-3.2
CPI, % yoy (aop)	59.2	18.3	18.1	17.5	11.4
Gross external debt, % of GDP	53.1	54.2	52.6	68.6	70.4

* Social Security Fund is not included.

Sources: National Statistical Committee, NBB, Minfin, GET forecasts

Forecast calculations were completed in June 2015. Next revision is scheduled for December 2015.

IPM Research Center
50Б Zakharova St., Minsk 220088, Belarus
Tel. (+375 17) 210 0105
E-mail: research@research.by
Internet: <http://www.research.by/>

German Economic Team Belarus
c/o Berlin Economics GmbH
Schillerstr. 59, D-10627 Berlin
Tel. +49 30 / 20 61 34 64 0
E-mail: info@get-belarus.de
Internet <http://get-belarus.de/>

MACROECONOMY

From recession to stagnation

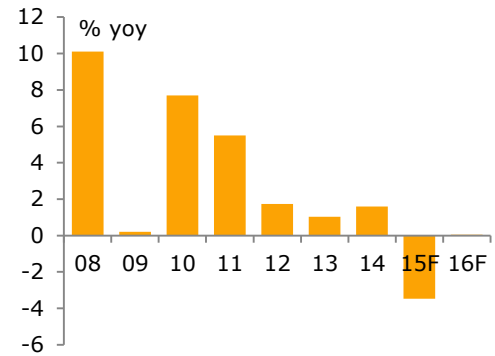
Sluggish growth in 2014 has explicitly demonstrated that the Belarusian economy had faded into a period of stagnation. The first half of the year was characterized by a gradual cyclical revival of the economy. But despite this, growth remained poor and was accompanied by persistent and huge external imbalances. Since the second half of 2014, new negative shocks – cheaper oil, and the Russian economy stepping into recession – turned the cyclical dynamics around and the economy dipped into a new slowdown. Furthermore, these shocks – given the inadequate buffers in the economy – resulted in a new currency crisis. The latter caused a deeper cyclical slowdown. Hence, a recession in 2015 has become inevitable.

The authorities could not ignore this new reality in terms of the current policy mix. Their response includes: (i) a quit from an exchange rate targeting regime; (ii) the adoption of monetary targeting accompanied with a managed float of the exchange rate; (iii) more conservative fiscal policy in terms of restricting expenditures; (iv) less directed credit to the economy; (v) an explicit quit from the artificial stimulation of wages, and even restricting wage growth in some cases. However, this notable progress in the macroeconomic policy mix has not been matched by any structural policy innovations. The only step ahead is the official recognition of structural weaknesses and the necessity of correspondent reforms, although the idea 'it's a bad time for structural reforms' still dominates. Thus, the authorities claim about their readiness to such reforms, but later, presumably in 2016 (which is associated with a new electoral cycle).

This new reality changes the profile of the national economy. During the last years, it was mainly perceived as one with: (i) huge external imbalances; (ii) financial fragility, and (iii) 'growth against all odds' policy (i.e. domestic demand stimulation). First, the adoption of a more flexible exchange rate framework along with improvements in secondary incomes (due to a deal with Russia, which assumes that export duties on oil products will be kept in the Belarusian budget, while earlier they were channeled to the Russian one) secures an improved situation in the current account. Second, the new exchange rate regime and more conservative monetary policy (under monetary targeting) discharge the vitality of financial fragility for 2015 (although it still matters in a longer-term context). Third, positive GDP growth has ceased to be a 'mantra' for the authorities, at least for the current year. In 2015, Belarus will certainly display a reduction in GDP, although the deepness and the duration of the recession is still questionable (depending on possible adjustments in policy in the second half of the year). Fourth, a new problem – unemployment – is arising on the agenda for Belarus.

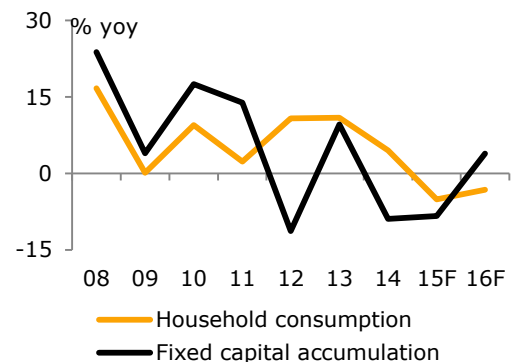
The new environment will cause a contraction of basically all components of aggregate demand in 2015. Exports to Russia are going to fall significantly because of the lack of demand there alongside with a lack of price competitiveness (it will be improving somehow throughout the year, but will remain poor, especially in the first half of the year). We expect that in real terms it will shrink by 4.7% (the contraction in value terms will be much more due to massive reductions in dollar prices). As for exports to other countries, we project a reduction by 3.6% in real terms. This will be driven negatively by a drop of exports to CIS countries (other than Russia). However, exports of potash fertilizers to non-CIS countries will compensate for these losses to some extent.

Real GDP growth



Source: National Statistical Committee, GET forecasts 2015–2016.

Household consumption and fixed capital accumulation



Source: National Statistical Committee, GET forecasts 2015–2016.

Contributions to GDP Growth

	2014	2015F	2016F
GDP	1.6	-3.5	0.0
Household consumption	2.9	-3.4	-2.1
Gross fixed capital formation	-3.6	-3.0	1.3
Net exports	1.3	6.0	-0.2
Other components+	1.0	-3.1	1.0
statistical discrepancy			

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

Source: National Statistical Committee, GET forecasts 2015–2016.

But despite a contraction of exports, net exports are going to improve. It is the policy of import restriction that will be mainly responsible for this trend. Moreover, less demand for imports will stem from less real incomes and adjustments in the real exchange rate. We expect that imports will decrease by 11.2% in real terms in 2015 (fully due to imports from countries other than Russia, while imports from Russia will grow somehow). Finally, we expect that net exports will contribute 6.0 percentage points to GDP growth.

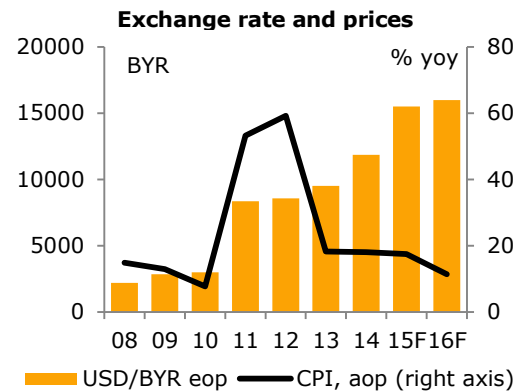
Domestic demand will contribute in 2015 negatively to output dynamics. Expenditures for household consumption are expected to contract by 5.1%, driven by a 4.3% fall in real wages and a reduction in employment. The two latter trends are expected to be the main outcomes of conservative policies carried out by the authorities. Government consumption expenditures are going to shrink as well (by 4.1%), according to their medium-term trend and the desire of the authorities to further constrain fiscal policy. Capital investments are going to decrease as well (by 8.4%), given tough financial constraints on firms and persistently high interest rates (although they are going to decrease gradually over the year). Hence, the contribution of domestic demand is going to subtract 9.5 percentage points from the GDP growth rate. Finally, we expect that GDP will shrink by 3.5% in 2015.

In 2016, the overall environment will be roughly the same: a lack of 'natural' growth along with an adverse environment. However, the low statistical base for major indicators, Russia's likely exit from its recession, and a possible loosening of the policy mix are going to secure at least a stable level of output. We suppose that chronic underinvestment and lower interest rates will give rise to more investment activity. Hence, capital investments will grow modestly (by 3.9%), although their absolute level will still be lower than in 2010. As for household consumption expenditures, we expect their further contraction, given tiny growth of real wages (by 2.7%) along with a further reduction in employment. An overall contribution of domestic demand to GDP growth will be near zero. Net exports will be roughly stable contributing near zero to GDP growth as well. Finally, we expect a situation of basically zero growth in 2016.

MONETARY ENVIRONMENT

Inertial high inflation and 'reshaping' of risks

Financial markets will still be fragile in the near future. However, the 'traditional' risk for Belarus – a sudden and huge exchange rate depreciation – will decrease significantly. The new exchange rate framework is likely to secure the absence of the building-up of a corresponding 'overhang'. We expect that the exchange rate will fluctuate in order to secure an almost balanced external position. Hence, we expect that by the end of 2015 the USD/BYR exchange rate will be near 15,500, and 16,000 by the end of 2016. In case of smooth exchange rate dynamics and conservative monetary policy, we expect that annual average inflation will be 17.5% in 2015 (mainly due to inflation inertia), and 11.4% in 2016. A new key risk arises – a deterioration of banks' loans quality. A correspondent burden will progress during 2015–2016, which will reflect in the dynamics of non-performing loans. However, statistical records are unlikely to reflect the whole scope of the problem, due to a number of accounting issues. This vitalizes the problem of uncertainty, information asymmetry and creates room for more instability in expectations. Furthermore, the problem of low-quality assets is likely to put the issue of bank recapitalization on the agenda.



Source: NBB, GET forecasts 2015–2016.

Alongside with a new environment, the inheritance of previous periods may play a role as well. Still there is a risk of more severe adjustment in case of a drastic decrease in international reserves. The latter is likely in case foreign debt cannot be refinanced and will be repaid mainly at the expense of reserves. Furthermore, high inflation and devaluation expectations will still persist and may empower or trigger itself a new financial shock.

PUBLIC FINANCES

Fiscal policy remains tight

Fiscal policy is expected to be tight. It will result in a surplus of 2.0% and 1.6% of GDP in 2015 and 2016, respectively (1% of GDP in 2014). However, this surplus is totally attributed to the changes in oil export agreements. Export duties on petroleum products are estimated to provide additional revenue of 2.6 and 2.9% of GDP in 2015 and 2016, respectively. It fully explains the increase of consolidated budget revenues from 28.2% of GDP in 2014 to 30.5% in 2015 and 30.8% of GDP in 2016. Other revenues are forecasted to remain stable as a share of GDP. Additional revenue from export duties is expected to be spent on debt repayment (principal), which is not reported as consolidated budget expenditures according to the classification.

Consolidated budget expenditures are projected to increase from 27.1% of GDP in 2014 up to 28.5 and 29.2% of GDP in 2015 and 2016, respectively. Most of the increase is related to public procurement and public transfers (by 0.6% of GDP in 2015 and further 0.4% of GDP in 2016), as the state will try to mitigate the fall of consumption in real terms. Hence, negative real GDP dynamics imply that even stable real public expenditures on procurement and transfers are associated with expenditures increase if measured in relation to GDP. Another growing expenditure line is interest payments on public debt which is related to the depreciation of the Belarusian ruble. Capital expenditures and expenditures on wages are expected to remain unchanged in relation to GDP, which supposes real reduction of the wage fund in the budget sector and state investment program.

BALANCE OF PAYMENTS

Sharp adjustment in the current account deficit

In 2014 the deficit of trade in goods amounted to USD 2.6 bn; exports fell by 2.2%, while the decrease of imports was more noticeable and reached 6.8%. For 2015 we expect a contraction of both exports and imports. However, losses in exports will be less than those in imports, which will improve the merchandise balance by roughly USD 0.7 bn. The contraction of Russia’s economy will decrease the sales of Belarusian capital goods, i.e. machines and equipment, as well as consumer goods to Russia. Furthermore, fewer exports will be attributed to the cutback of trade in petroleum products due to falling prices. Fewer imports will be caused by a reduction of supply of capital, intermediate, and consumer goods both from Russia and non-CIS countries due to the shrinking of domestic demand. In 2016 we project a growth of both exports and imports in nominal terms by roughly 9%. We expect that in 2015 the balance of merchandise trade will be negative and amount to USD 1.9 bn. In 2015, the deficit of the balance of merchandise trade will widen to USD 2.3 bn.

In 2015 and 2016, the balance of trade in services will be positive at around USD 2.3 bn and 2.4 bn, respectively.

Fiscal indicators, % of GDP

	2014	2015F	2016F
Consolidated revenues	28.2	30.5	30.8
Consolidated expenditures	27.1	28.5	29.2
Consolidated budget balance	1.0	2.0	1.6

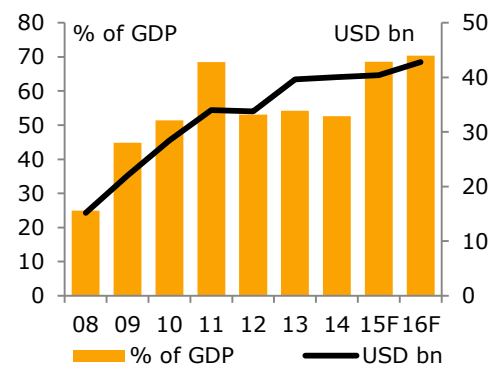
Source: Ministry of Finance, GET forecasts 2015–2016.

Merchandise trade (growth rate in USD)



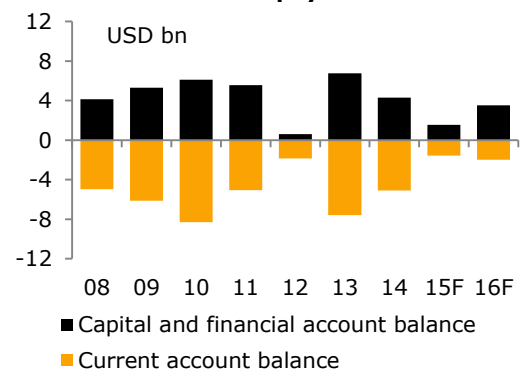
Source: National Statistical Committee, GET forecasts 2015–2016.

Gross external debt



Source: NBB, National Statistical Committee, GET forecasts 2015–2016.

Balance of payments



Source: NBB, National Statistical Committee, GET forecasts 2015–2016.

The export growth will come from an increase in oil and gas transit and transportation services, while service import growth will be supported by an expansion of construction, financial services, and royalties.

We expect that the balance of trade in goods and services will be positive, amounting to USD 0.4 bn in 2015 and 0.2 bn in 2016.

We expect that the balance of primary incomes will be negative in 2015 and 2016 as a consequence of the increase of interest payable under general government 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 turn positive in 2015 and 2016 because, according to the agreement with Russia, Belarus does not need to transfer the export duties on oil products manufactured from Russian oil and exported to non CIS countries to the Russian budget anymore. In addition, the inflow of customs duties accrued according to the agreement between Russia, Belarus and Kazakhstan on the distribution of import customs duties within the Customs Union exceeds the amount transferred to the account of the authorized agency in the Eurasian Economic Union.

We expect that in 2015 the negative current account balance will shrink to USD 1.5 bn, or 2.6% of GDP due to a reduction of the deficit of secondary income. In 2016, it will grow slightly: USD 2.0 bn or 3.2% of GDP.

Capital and financial account: Repayments in focus

We expect that both in 2015 and 2016 the net FDI inflow will contract modestly due to the recession (USD 1.6 bn in both years). The FDI inflow will be attributed to reinvested earnings and acquisition of equity capital in industry, banking and service sectors.

In 2015 and 2016 the necessity of repayment of external debt under previously attracted loans (including the repayment of the principal amount of Russia's and the Anti-Crisis Fund's loan, as well as the debut Eurobond) and financing the current account deficit 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 do not expect an inflow of portfolio investments in 2015 and 2016 due to a potential Eurobonds issue, as market conditions are unfavorable and the sovereign was recently downgraded by Moody's.

Annex. Tables

		2012	2013	2014	2015F	2016F
Table 1. GDP						
Nominal GDP	BYR bn	530 356	649 111	778 456	854 120	957 644
	USD bn	63.6	73.1	76.2	58.9	60.8
Real GDP	% yoy	1.7	1.0	1.6	-3.5	0.0
Household consumption	% yoy	10.8	10.9	4.5	-5.1	-3.2
Public consumption	% yoy	-1.0	-2.1	-1.9	-4.1	0.2
Gross fixed capital formation	% yoy	-11.3	9.6	-8.9	-8.4	3.9
Exports	% yoy	11.1	-17.4	14.7	-4.1	4.8
Imports	% yoy	10.8	-6.1	9.3	-11.2	4.4

Table 2. Fiscal Indicators*

Consolidated budget revenues	BYR bn	157 955	189 232	219 281	260 792	294 867
	% of GDP	29.8	29.2	28.2	30.5	30.8
EPT revenues	BYR bn	19 535	21 525	19 994	22 370	24 367
	% of GDP	3.7	3.3	2.6	2.6	2.5
VAT revenues	BYR bn	45 457	56 223	69 829	76 617	85 903
	% of GDP	8.6	8.7	9.0	9.0	9.0
PIT revenues	BYR bn	19 319	26 992	32 092	34 820	39 830
	% of GDP	3.6	4.2	4.1	4.1	4.2
Consolidated budget expenditures	BYR bn	155 169	187 751	211 154	243 774	279 785
	% of GDP	29.3	28.9	27.1	28.5	29.2
Current expenditures	% of GDP	22.8	22.5	21.8	23.0	23.5
Capital expenditures	% of GDP	6.4	6.8	5.5	5.5	5.7
Consolidated budget balance	% of GDP	0.5	0.2	1.0	2.0	1.6

Table 3. Balance of Payments and External Debt

Current account balance	USD m	-1862	-7567	-5094	-1546	-1975
	% of GDP	-2.9	-10.3	-6.7	-2.6	-3.2
Export of goods	USD m	45 574	36 540	35 736	27 110	29 546
Import of goods	USD m	45 009	41 134	38 334	29 028	31 819
Balance of services	USD m	2 269	2 253	2 199	2 321	2 448
Financial account balance (analytical view)	USD m	602	6 755	4 289	1 552	3 527
Foreign direct investments (FDI)	USD m	1 308	1 984	1 799	1 632	1 598
Portfolio investments	USD m	191	59	9	-1 000	0
Gross external debt	% of GDP	53.1	54.2	52.6	68.6	70.4

Table 4. Money, Inflation and Exchange Rate

Base money	%, yoy eop	61.6	13.4	13.8	8.0	2.5
CPI	%, yoy aop	59.2	18.3	18.1	17.5	11.4
Exchange rate, USD/BYR	eop	8 336	8 876	10 216	15 500	16 000

*- Social Security Fund is not included into consolidated budget.

Sources: National Statistical Committee, Ministry of Finance, NBB, GET forecasts 2015–2016.

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 65 per barrel on average in 2015 and USD 70 in 2016.
- Belarus will get 22.5 m t of crude oil from Russia in 2015 and 23 m t in 2016.
- The prices of imported gas from Russia will be USD 170 per tcm (yearly average) both in 2015 and 2016.
- In 2015 the government will obtain USD 1.5 bn of oil duties (USD 1.7 bn in 2016), and will attract USD both in 2015 and 2016 1.5 bn of new borrowings, which will partially refinance the repayments scheduled.
- The Russian economy will decrease by 3.5% yoy in 2015 and will display zero growth in 2016.

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 the 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

Research products and publications of the project are available via the Internet at the web-sites of the IPM Research Center <http://research.by/> and German Economic Team Belarus www.get-belarus.de.