

Economic conditions at mid-year: is this time different?

In the first half of 2018, economic and financial conditions further improved as compared to 2017, which marked the end of the recession during 2015-2016.

This recovery will – with a slight deceleration in the second part of this year - continue during 2018 and 2019. Real economic growth will amount to 2.8% this year, and 2.5% in the next. Annual average inflation is forecast at a level of 6% in both years – this is a major success for the National Bank and its monetary policy. Growth of public debt has come to a stop, with debt remaining at a level of around 50% of GDP.

The external sector mirrors these positive domestic developments. The current account deficit will amount to 2.5% of GDP in 2018, rising slightly to 2.7% in 2019. The exchange rate is broadly stable, and foreign reserves are growing in the medium term, even though their absolute level is still too low.

As a result, two major rating agencies improved their assessment of the creditworthiness of Belarus and delivered respective upgrades.

Recent developments

After surprisingly high real GDP growth of 2.4% in 2017, positive dynamics even accelerated in the first half of 2018: the Belarusian economy grew by 4.7% yoy in the period from January to May. The main drivers of the recovery in 2017 were external factors such as the resolution of the gas dispute with Russia and the overall stabilization of the Russian economy.

Industrial production remains the main driving force on the supply side, with manufacturing growing by an impressive 9% yoy in the first five months of 2018. Strong positive dynamics can be also noted for domestic trade (+8.6% yoy) and construction (+7.1% yoy), the latter growing for the first time since 2013. On the demand side, the broad economic recovery is primarily supported by a long-awaited pick up of investment activity (+15% yoy). External trade continues to catch-up after many years of decline, with exports of goods growing by 22% yoy in the period from January to May. This positive dynamic is for the most part due to a strong increase of exports to the European Union of 52.5% yoy.

Inflation – one of the success stories and a major factor behind the recent economic recovery – remains firmly under control, with consumer prices growing by 4.4% yoy in the first five months of 2018. Thus, inflation is clearly below the National Bank's current target of no more than 6%.

Strong growth dynamics can be noted for real wages, which grew by 13.4% yoy in the first five months of 2018. As such, the disposable income of households increased by 7.4% yoy in the period from January to April and is expected to result in a growth of private consumption.

Outlook for 2018-2019

The following table provides an overview of the development of key macroeconomic indicators.

Selected economic indicators

	2017	2018*	2019*
Real GDP growth, % change yoy	2.4	2.8	2.5
Inflation, % change yoy (annual average)	6.0	6.0	6.0
Current account, % of GDP	-1.8	-2.5	-2.7
Budget deficit, % of GDP	-1.7	-2.4	-3.0
Gross government debt, % of GDP	51.0	49.5	49.9

Source: IMF, Belstat *Estimations/Projections

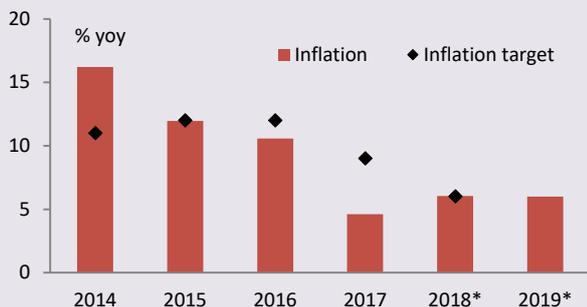
Real sector/GDP

With a continuing recovery across all sectors and the long-awaited pick up of investment activity, we expect real GDP to grow by 2.8% in 2018. This implies a certain deceleration from the very high pace of growth recorded in the first half of the year, but is nevertheless somewhat higher than in 2017. Economic growth will remain at a similar level in 2019 (2.5%).

Inflation and monetary policy

The monetary policy conducted by the National Bank was clearly successful, leading to a historically low inflation rate of 6% (annual average) in 2017 and as such pushing inflation below its 2017 target rate of 9%. The new inflation target for 2018 was decreased to a rate below 6% at the end of the year. In response to the falling inflation during the first five months of 2018, the National Bank's main refinancing rate was reduced from 10.5% to 10% per annum in June 2018. Overall, inflation is expected to remain stable on average during 2018/2019 at about 6%.

Inflation



Source: IMF, National Bank of Belarus *Estimations/Projections;
Note: end of period

External sector

As a result of an export driven economic recovery, a significant improvement of the current account deficit was noted for 2017. It is expected that the deficit will remain at a moderate level during 2018/2019, slightly increasing to 2.5% and 2.7% of GDP, respectively. Such deficits should not endanger the relatively stable – yet flexible – exchange rate, as the associated financing needs are rather manageable.

The medium-term growth in official foreign exchange reserves is another positive development. Currently, they amount to USD 6.8 bn, after USD 4.2 bn in early 2016. Still, according to international benchmark metrics like import coverage, they need to rise further.

Public finances

After a significant improvement in 2017, the budget deficit is expected to widen again, reaching 2.4% of GDP in 2018 and 3.0% of GDP in 2019. A different treatment of certain transaction by the IMF in comparison to the national definition (that reported a budget surplus of 2.6% of GDP in 2017) still remains a major inconvenience and complicates the overall analysis of public finances.

The previous increase of public debt was successfully stopped in 2017, with the level amounting to 51% of GDP. It is expected that public debt will remain at a similar level in 2018 (49.5% of GDP) and 2019 (49.9% of GDP).

Conclusion

Belarus is clearly on a path of economic and financial recovery after the difficult years 2014-2015. This positive development has also led to rating upgrades by the two major international agencies Moody's and Fitch during 2018. In a similar move, the Organization for Economic Cooperation and Development (OECD) has improved Belarus' risk rating, which will bring down the cost of loans for Belarusian companies.

The economic recovery, which has also brought wage and income gains for the population after years of

hardship should be seen as an opportunity to move the structural reform agenda forward. Growth rates of below 3% can be seen from a positive angle after years of declining GDP; they are, however, clearly not sufficient from a perspective of catching up to more developed countries in the region.

In a way, Belarus is now harvesting the fruits of a broadly successful macro-financial stabilisation policy it pursued during the crisis. However, the current recovery should not lead to a premature relaxation of this policy. The country has experienced a number of "boom-bust" cycles in a past, where prematurely relaxed macro policies led straight into financial and economic crises. Policy makers should be aware of past policy mistakes and make sure that this time is different!

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