

Economic recovery continues, but loses steam

The Belarusian economy continued to recover in 2018 (3.0%), with 2.4% growth forecast for 2019. The recovery, however, is cyclical in nature and already beyond its peak. Without any further economic reforms, medium-term growth is likely to remain capped at around 2.0% per annum.

The so-called Russian tax manoeuvre poses a crucial risk for the years to come, as it will be gradually implemented through 2019-2024. A negative impact on external and fiscal accounts is already expected to materialise in 2019, if the issue is not resolved through ongoing negotiations. Especially the fiscal situation, that has already taken a turn for the worse at the end of 2018, is likely to deteriorate further.

Inflation, which amounted to 4.9% on average in 2018, has reached historically low levels and can be expected to remain firmly under the National Bank's control in 2019. The external situation in 2018 was characterised by a stable exchange rate, but also a widening current account deficit. The latter is projected to further worsen in 2019, as the Russian tax manoeuvre unfolds. Exports and imports continue to grow dynamically, but are still on their way to catch up to their 2012 highs. The growth of foreign exchange reserves came to a standstill; they will likely remain at the same level in 2019.

Main economic developments in 2018

The positive growth dynamics of 2017 continued in 2018, resulting in an increase of the real gross domestic product (GDP) by 3.0%. However, against the background of growth reaching 4.5% during the first half of 2018, this implies a significant slowdown of economic activity towards the end of 2018.

On the supply side, economic growth remained widely spread across all sectors, but was characterised by an overall slowdown of economic activity during the second half of 2018 – especially in the construction sector. Moreover, the agricultural sector showed rather weak performance due to external factors: several lasting supply interruptions of Belarusian dairy products to Russia in February and June resulted in a decline in sectoral output (-4.0%) in 2018.

Looking at the demand side, investment – one of the main economic drivers in 2017 – increased once again in 2018 and as such remained a key growth factor. However, a similar slowdown can be observed: while investment increased by 12.4% over the first half of the year, activity significantly slowed down during the second half, resulting in growth of only 5.4% in 2018. Real

wages – another important factor – increased by 11.6% in 2018. As such, private consumption gave a notable boost to domestic trade, which grew by 5.8% in 2018.

The positive catch-up dynamics of external trade continued in 2018, with imports of goods expanding by 12.2% and exports growing by 15.3%. The latter was for the most part driven by a strong boost of goods exports to the European Union (29.9% in 2018). Here, mineral products were the key driver, being responsible for roughly 60% of total growth of goods exports to the EU.

Outlook for 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	3.0	2.4
Inflation, % change yoy (annual average)	6.0	4.9	5.0
Current account, % of GDP	-1.6	-2.6*	-4.0
Budget balance, % of GDP	-0.3	-1.3*	-3.9
Gross government debt, % of GDP	53.4	51.7*	54.1

Source: IMF, Belstat *Estimations/Projections

Real sector/GDP

The recent economic recovery is primarily cyclical in nature and already beyond its peak. The downward trend that emerged during the second half of 2018 is expected to continue in 2019. First numbers for January 2019 suggest real GDP growth of 0.7% yoy, which is much lower than the 3.0% yoy one year ago. According to the IMF, medium-term growth will remain limited at around 2.0%. This is already reflected in the forecast for 2019, which assumes real GDP growth of 2.4%. Only ambitious and sustainable economic reforms – e.g. of the state-owned enterprises (SOEs) – can lead Belarus back on track to higher growth rates.

Inflation and monetary policy

The significant decrease of inflation is a clear sign of the successful monetary policy conducted by the National Bank. In 2018, consumer prices grew on average by historically low 4.9% and inflation is projected to remain at 5.0% in 2019. The stable situation is also reflected in the National Bank's decision of February 2019 to once

again keep the main refinancing rate at 10%, where it remains since June 2018. For 2019, the target inflation was lowered from 6% (end of period) to 5%. While the target appears consistent with current forecasts, considerable inflationary pressure of domestic demand could play a role in 2019.

External sector

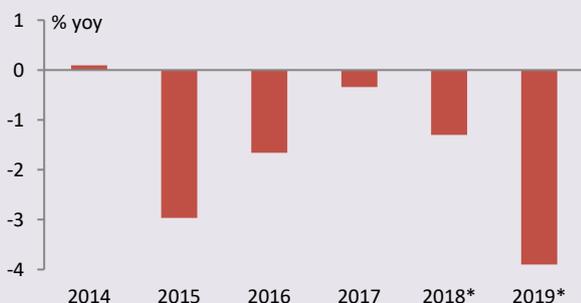
After a significant improvement in 2017, the current account deficit is expected to widen once again in 2018 (2.6% of GDP) and 2019 (4.0% of GDP). Here, the Russian tax manoeuvre, which envisions a gradual shift from export taxation of crude oil towards producer taxation, plays an important role. For Belarus it means that import costs of crude oil will rise and the secondary income generated from re-exports of crude oil will shrink. According to estimates, this will have a negative impact on the current account deficit of around 0.7% of GDP alone in 2019 if not compensated.

Official foreign exchange reserves grew significantly in 2017, but stagnated in 2018, amounting to USD 7.2 bn at the end of the year. It is not expected that a further increase in reserve assets will take place during 2019. According to international benchmarks, a country’s reserves should be able to cover at least 3 months of imports. With current import coverage roughly amounting to 2 months, Belarus has little room to navigate through external shocks.

Public finances

Due to rising expenditures (financing the nuclear power plant, recapitalisation of SOEs), the budget deficit widened once again in 2018 (1.3% of GDP). The negative trend is expected to continue, with forecasts suggesting that the deficit will reach 3.9% of GDP in 2019. Partly, this is also a consequence of the Russian tax manoeuvre: in 2019, the Belarusian budget will lose revenues from the mineral oil export tax amounting to roughly 0.5% of GDP.

Budget balance



Source: IMF, *Estimations/Projections

A similar picture can be observed for public debt: after a stabilisation in 2017 (53.4% of GDP) and a decline in 2018 (51.7%), a further increase in 2019 is expected (54.1%). Overall, this implies a deterioration of the fiscal situation in 2019.

Conclusion

The Belarusian economy has grown in 2018 for the second year in a row, and is forecast to grow further this year. This means that the country has clearly emerged from the crisis of 2015-16, which is very positive. At the same time, the recovery is cyclical in nature, and already beyond its peak. This leaves Belarus with a mid-term outlook of around 2% growth per annum, which is far too low to catch up with its more advanced neighbours.

A new risk is the Russian tax manoeuvre in the oil sector, which also affects Belarus. While the negative impact on external and fiscal accounts is relatively limited for 2019, this reform is implemented gradually over 2019-2024. This means that the cumulative impact on Belarus will be much higher going forward if the current negotiations between the two countries won’t resolve this issue.

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GET Belarus has been engaged in political dialogue with reform-oriented decision-makers from the Belarus government since 2003. It is funded by the German Federal Ministry for Economic Affairs and Energy and implemented by the consulting firm Berlin Economics.



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