BELARUS
Economic Update
May 26, 2020

WORLD BANK GROUP

- ***Belarus's economy is being hit by the COVID-19 pandemic, ongoing contraction in its main trading partners, and the oil-price shock.***
- ***The impact of the pandemic shock is expected to be temporary but severe, with the economy projected to contract at the sharpest pace in nearly 25 years.***
- ***A robust, early response will help to contain the socio-economic fallout from COVID-19, support a faster recovery and facilitate an orderly adjustment. Strengthened safety nets will be essential to prevent poverty from rising.***

Recent Economic Developments

Belarus has entered the COVID-19 crisis from a position of sub-par growth. In recent years, anemic growth has reflected a concentrated export structure that has left the economy vulnerable to volatile energy prices, delayed structural reforms related to under-performing SOEs and a dollarized banking sector. After growing by just 1.2 percent in 2019, the economy contracted by 0.3 percent in Q1 2020 as a temporary halt in oil supplies by Russia contributed to a 16 percent yoy fall in export revenues amidst large contractions of oil product and fertilizer exports. Coupled with declining remittance inflows and a weaker Russian ruble, the BYN has depreciated by almost 19 percent against the US$ since the start of the year. The weaker currency has exacerbated pressures on corporate balance sheets, where FX-denominated loans account for almost half of the total lending stock.

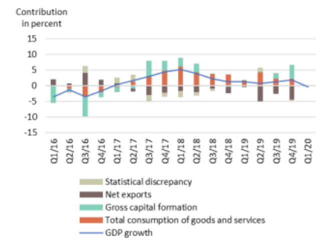
Administrative measures have been deployed to limit inflation pass-through from depreciation. Price pressures have risen, albeit modestly, with headline inflation reaching 4.9 percent in March (3m/3m saar), from a December low of 4.1 percent. However, broad money supply growth at 14.8 percent yoy in March 2020 exceeded the 11 percent threshold target of the NBRB. In response, the government has set a limit of 0.5 percent for monthly price increases during Q2 for basic commodities. However, real wage growth has been delinked from productivity in the SOE sector, which may create pressures for wage inflation later in 2020. In January-February 2020, real wages in the economy rose 8.6 percent, while productivity growth remained negative.

The first quarter contraction has negatively impacted consolidated government revenues. In Q1 2020, revenues dropped by 5.5 percent in real terms yoy, driven by a plunge in profit tax revenues and proceeds from foreign trade which led to a 1.5pp of GDP reduction of tax revenues. Expenditures, however, increased by 4.8 percent in real terms led by strong growth in capital expenditures and capital transfers to organizations (39 percent in real terms) and spending on wages and salaries (12.5 percent), which was partially offset by lower interest spending and contained expenditures on goods and services. Although this enabled the government to post a surplus of just 0.8 percent of GDP in Q1 2020 (net of quasi-fiscal expenditures) as compared to 3.8 percent of GDP a year ago, it will likely prove a temporary reprieve in the face of sustained revenue pressures during 2020.

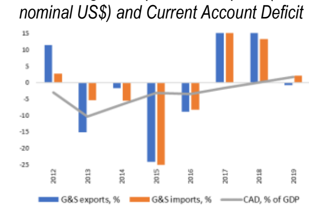
The public debt structure exposes public finances to currency risk. Almost all public and publicly guaranteed debt – 46.8 percent of GDP in 2019 – is denominated in FX. In 2020, the bulk of public external debt in 2020 is due mainly to Russia (43 percent of total) and repayments on tied loans to China (26 percent of total), followed by government FX bonds issued on the domestic market (US$ 853 million). External liquidity is low and declining: at US$5.3bn, FX reserves (excluding gold) in April were one-fourth lower than in January and amounted to about 1.5 months of goods and services imports. Amid heightened global risk aversion, Belarus's sovereign bond spreads have doubled since January to 650 bp in mid-April, the second highest in the region (after Ukraine).

The policy response to the COVID-19 pandemic economic shocks has been modest. The government has deployed additional resources for the healthcare sector and approved tax relief and tax and rental payment deferral measures largely to be decided at the local level. The monetary authorities have eased some prudential banking sector regulations, including softening of asset classification requirements and looser requirements on FX loans, and, among other measures, recommended commercial banks to suspend dividend distributions and refrain from increasing interest rates in restructured debts. Additional scope for more decisive fiscal and monetary stimulus is, however, limited.

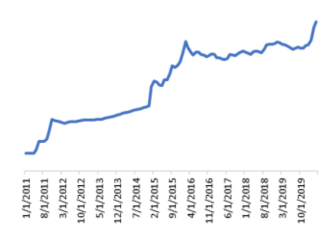
Contribution to Real GDP Growth, %



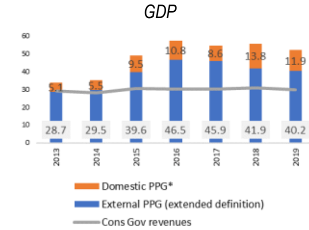
% Change of Exports and Imports (in nominal US$) and Current Account Deficit



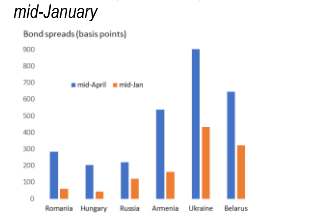
BYN/US$ exchange rate



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



Bond Spreads (basis points): mid-April vs. mid-January



Medium-term Outlook

The economy is anticipated to contract by at least 4 percent in 2020 – the largest decline in 25 years – and growth is expected to remain weak in the medium term. This point forecast is being surrounded by elevated uncertainty and should be understood as just one among several possible scenarios. As a small, open, commodity-exporting economy, Belarus is heavily exposed to the deep ongoing contractions in its main trading partners (Russia and the EU), the collapse of global oil prices and global financial volatility caused by the COVID-19 pandemic. This comes on top of a significant terms-of-trade shock as Russia gradually phases out discounts on its crude oil supplies to Belarus by 2025 (the "tax maneuver"), that will affect exports, fiscal revenues and the competitiveness of Belarus's energy-exporting and energy-intensive firms. This will weigh on growth and keep the current account deficit elevated even after the global pandemic ebbs and its economic impacts ease.

After supporting the economic recovery in response to the COVID-19 pandemic, medium-term fiscal reforms will be needed to safeguard fiscal sustainability. Fiscal revenues from oil trade and transit (amounting to 2.3 percent in 2019) are expected to vanish in 2020, with deteriorating economic activity contributing to lower receipts from the broader economy as the recession takes hold. Widespread economic weakness also poses large fiscal contingent liability risks in the state-owned sector. Public finances will remain under pressure given large debt repayments in the pipeline although a recently announced restructuring of debt to Russia for the construction of the nuclear power plant will provide some relief. To anchor fiscal sustainability and to generate additional resources to finance the support to households and firms in the recovery post-COVID-19, reforms in public finances will be required. They include rationalization and increasing expenditure efficiencies in key areas, including reduction in support to loss-making SOEs, a lower public sector wage bill and tax expenditure reform. A credible medium-term fiscal reform plan will also foster a virtuous cycle of greater investor confidence, lower borrowing costs and increased access to financing and eventually better growth prospects.

Downside risks prevail. Domestic risks relate to delays in critical reforms vis-a-vis the banking sector and SOEs that are needed to shore up banking sector stability and to lift productivity in the economy, or an inability to slow the domestic transmission of COVID-19. External risks relate to deeper-than-expected recessions in trading partners, notably Russia, and continued global financial volatility that affects the cost of external funding. Restrictions introduced to combat the pandemic in Russia have already affected Belarus' exports. But even when these are eventually eased, absent improvements in cost-competitiveness and productivity, Belarusian exporters may find it hard to rebuild market share given intensified competition from Russian firms.

A strong, early crisis response– robust, transparent disease surveillance, balanced use of social restrictions, strengthened health system preparedness and support to cash-strapped individuals and firms – will enable a faster return to normal. These measures include, but are not limited to, the strengthening of social safety nets, deferment of social contributions and key taxes, lending and employment subsidies, and temporary suspension of key business regulations. By reducing the scale of economic and financial distress now, such measures reduce the risk of lasting damage to the economy and strain on public finances in the future, e.g. due to rising bailout costs. *A Special Topic Note* on *Economic Policy Response to the Pandemic* reviews the experience of other countries' measures against the COVID-19 and formulates possible policy measures for Belarus. Yet, immediate steps do not diminish the medium-term policies to accelerate critical banking, SOE and business and regulatory reforms to support economic diversification and the emergence of a dynamic private sector led economy to increase resilience to external shocks and to lift economic productivity and long-term growth**.**

Key Macroeconomic Indicators

	2017	2018	2019	2020f	2021f	2022f
GDP growth, at constant market prices	2.5	3.0	1.2	-4.0	1.0	1.2
Private Consumption	4.7	8.2	5.5	-5.0	3.7	2.0
Government Consumption	-0.9	-1.0	5.1	-2.4	1.1	-0.4
Gross Fixed Capital Investment	5.5	4.9	0.2	-4.5	-6.3	1.2
Exports, Goods and Services	7.5	3.9	-0.8	-12.2	10.2	3.3
Imports, Goods and Services	11.1	7.9	4.2	-11.3	5.7	2.4
CPI (pa), percentage change	6.0	4.9	5.6	8.4	8.3	6.6
Current Account Balance, % of GDP	-1.7	0.0	-1.8	-5.8	-3.8	-3.7
Consolidated Government Balance, % of GDP (net of quasi-fiscal expenditures)	3.0	4.0	1.2	-3.1	-2.4	-2.5
Government Debt*, % of GDP	52.9	47.8	43.7	55.2	50.6	49.4
Poverty rate ($5.5 a day in 2011 PPP terms)	0.8	0.7	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

Contact info: *Tehmina Khan* *Tkhan@worldbank.org* | *Kiryl Haiduk* *khaiduk@worldbank.org* | *Maryna Sidarenka* *msidarenka@worldbank.org*

+375 (17) 359-19-50 ● www.worldbank.org/belarus