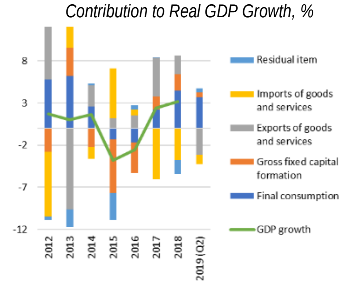
WORLD BANK GROUP

BELARUS
Economic Update
November 28, 2019

- *Economic growth decelerated in 2019, as exports fell under the pressure of the weakening global economy and faltering domestic demand.*
- *The macroeconomic growth outlook for 2020-2021 is weak due to continued deterioration in terms of trade, limited space for domestic demand stimulus, and longstanding structural bottlenecks.*
- *Improving growth prospects will require measures to strengthen competition and improve resource allocation, with a focus on SOE restructuring, deepening of the financial sector, and better targeting of social protection.*

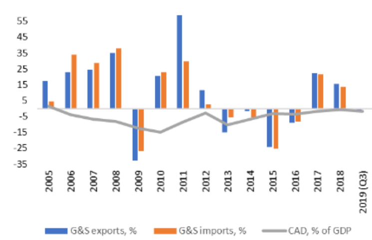
Recent Economic Developments

Contribution to Real GDP Growth, %



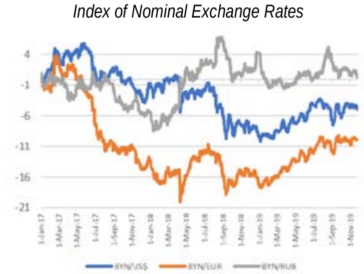
Economic growth has slowed considerably to 1 percent y/y in the first three quarters of 2019, from 3.7 percent in January-September 2018. The main driver of the slowdown has been declining exports due to weaker external conditions. Merchandize exports have declined by 3 percent in nominal US$, in sharp contrast to the 18.3 percent increase during the same period of 2018. Exports to the EU and non-CIS countries have declined by 17.3 and 8.7 percent, respectively, while exports to Russia and the CIS countries have increased only modestly by 3.7 and 1.6 percent, respectively. In this context, domestic demand has been supported by growing wages and household consumption. Real wages continued to rise – by 7.6 percent in January-September 2019, well above labor productivity growth of 1.5 percent, and household consumption increased by 6.5 percent in real terms in the first two quarters of 2019.

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



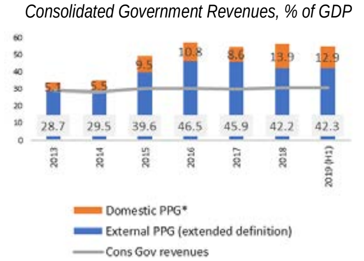
On the supply side, output stagnated in manufacturing and other key sectors. The cumulative contribution of agriculture, industry, construction, and transport to growth was only 0.5 percent in the first three quarters of 2019. The industrial sector grew by just below 1 percent, in contrast to almost 7 percent growth during the same period of 2018. Weaknesses in the corporate sector have translated into an almost twofold increase in the volumes of bad loans in the banking system–from 3.5 percent on May 1, 2018 to 5.5 percent by September 1, 2019.

Index of Nominal Exchange Rates



Budget revenues have declined as growth has slowed and the impact of Russia's "tax maneuver" has materialized, while expenditures have increased. In the first three quarters of 2019, real consolidated government revenues shrank by 0.2 percent, reaching 29.6 percent of GDP, largely due to declining tax revenues on foreign trade (by 18.5 percent y/y in real terms) stemming from lower duties on exports of oil products. Government expenditures, on the other hand, increased by 3 percent in real terms, totaling 26 percent of GDP, driven by the growth of subsidies and transfers (by 5.2 percent y/y) and spending on wages and salaries (by 4.8 percent y/y), while debt service payments dropped slightly to 2 percent of GDP. The ratio of public debt – the sum of external debt (including extended definition of public debt) and domestic debt – amounted to 49.6 percent. At the same time, in the first six months of 2019, the budget allocations to cover losses of state-owned enterprises (SOEs) and public sector organizations increased by 18 percent y/y in nominal terms (10.3 percent in real terms), reaching almost BYN 1.2 billion (equivalent to US$600 million, or about 2 percent of GDP).

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



Inflation softened to 5.3 percent in September 2019 from 5.6 percent at end-2018 after a short-lived acceleration to 6 percent in mid-2019. The tick up in inflation in mid-2019 was due to a scheduled increase in utility prices and a seasonal spike in food prices. With broad money growth remaining within the established ceiling, the National Bank reduced its policy rate to a historic low level of 9.5 percent p.a. in August, and then to 9 percent in November 2019, from 10 percent set in mid-2018. Notwithstanding the slowdown in exports, between September 2018 and September 2019, the BYN/US$ appreciated by 1.8 percent in nominal terms. Exchange rate flexibility has been retained and additional forex market liberalization measures implemented. Gross international reserves amounted to US$9.1 billion at the end of October 2019, covering more than two and a half months of goods and services imports.

Medium-term Outlook

Economic growth for 2020-2021 is projected to remain below 1 percent due to continued weaknesses in the terms of trade, limited space for demand stimulus measures, and longstanding structural bottlenecks. This projection is based on the assumptions of no immediate compensation for Russia's "tax maneuver" and limited progress on structural reforms.

The outlook is clouded by the lack of agreement on possible compensation for Russia's new energy taxation system and uncertainties related to broader discussions on integration with Russia. Going forward, Russia's "tax maneuver" is projected to subdue economic growth through both fiscal and export channels. First, the gradual phasing out of export duties will reduce revenues and call for additional fiscal tightening. Second, higher input prices for Belarusian oil refineries will negatively affect price competitiveness of their exports, and thus production in the petrochemical sector.

Continuous weakening of global demand, further deterioration of the terms of trade, the elevated public debt and limited space for domestic demand stimulus will limit economic growth in Belarus. In case of a further decline in export revenues, additional foreign borrowing would be required to offset the loss of foreign exchange. The room for demand stimulus is limited, with fiscal policy constrained by the burden of debt repayments and high levels of contingent liabilities related to state-owned enterprises (SOEs) and commercial banks. Monetary policy efficiency is weakened by high dollarization, with the foreign currency component of broad money still close to 60 percent. Exchange rate adjustment would also further impact the high share of foreign currency-denominated corporate (above 50 percent) and public (above 97 percent) debt.

Advancing structural changes is key to reducing vulnerabilities and raising the growth potential of the economy. One of the main priorities is to strengthen competitiveness and diversify exports through improvements to the regulatory environment and restructuring of the enterprise sector, particularly SOEs with increasing losses and low productivity. Recent measures to stimulate private sector development have limited effects, unless progress is also made on SOE restructuring to allocate resources for more productive uses and to reduce fiscal risks. To cushion the impact of restructuring on vulnerable groups, social safety nets need to be strengthened by introducing unemployment assistance mechanisms and improved targeting of means-tested support programs. While inflation deceleration is helping real loan rates to fall, lending to the private sector has not recovered to its pre-recession levels. The *Special Topic Note on Access to Finance* reports recent findings of the Business Environment and Enterprise Performance Survey (BEEPS) for Belarus, which collects perception of the business environment, including on access to finance. While the findings show that access to finance is an important bottleneck to private sector growth, improvements along this dimension will require an improved overall allocation of credit across the economy.

Key Macroeconomic Indicators

	2016	2017	2018	2019f	2020f	2021f
GDP growth, at constant market prices	-2.5	2.5	3.0	1.0	0.9	0.5
Private Consumption	-3.2	4.8	8.3	5.5	2.5	1.2
Government Consumption	0.3	-0.9	-0.1	-0.3	0.7	3.0
Gross Fixed Capital Investment	-14.5	5.5	4.9	0.5	6.3	-10.4
Exports, Goods and Services	2.6	7.5	3.5	-0.2	1.6	1.7
Imports, Goods and Services	-1.4	11.1	6.9	1.5	3.9	-3.6
Net Exports, % of GDP	1.7	-0.8	-0.7	-1.1	-1.0	3.0
Current Account Balance, % of GDP	-3.5	-1.7	-0.4	-1.9	-5.6	-2.6
Terms of Trade, % change	-5.2	5.7	6.3	-0.3	-2.5	-0.1
Consolidated Government Balance, % of GDP (net of quasi-fiscal expenditures)	0.3	3.0	4.0	1.4	-1.3	-2.5
Government Debt*, % of GDP	53.4	52.9	47.8	44.7	49.4	51.6
Poverty rate ($5.5 a day in 2011 PPP terms)	0.7	0.8	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

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