BELARUS: Muddling through amidst sanctions

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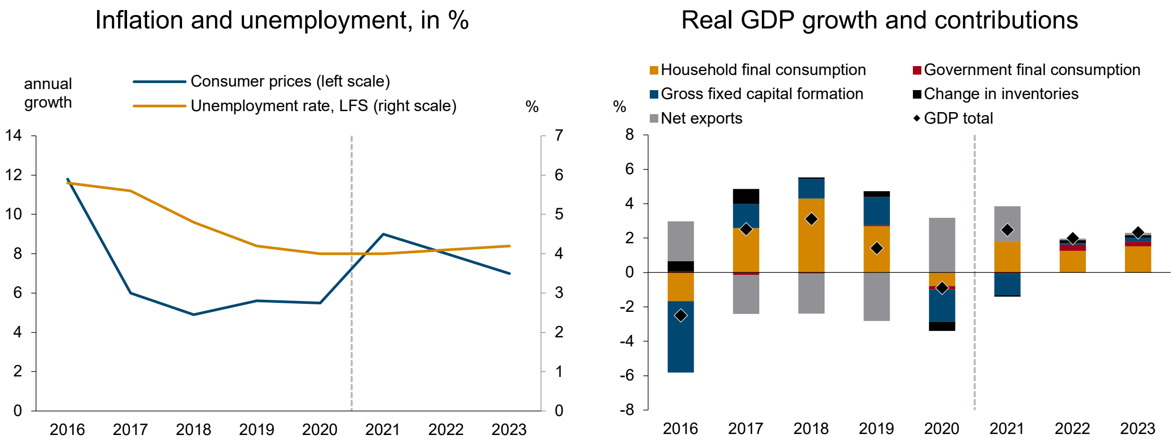
The restoration of economic relations with Russia has outweighed the negative effect of the Western economic sanctions. Economic growth has been higher than expected, but the upturn has been accompanied by a surge in inflation. Belarus has taken an important step towards closer economic integration with Russia by signing 28 integration programmes. The figures for 2021 have improved slightly, and GDP is expected to grow by some 2.5% for the year as a whole. However, the prospects for the coming years remain bleak.

Figure 4.2 / Belarus: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The Belarusian economy is feeling the heat of the Western economic sanctions that were imposed following the forced landing of a Ryanair flight in May. For the first time, these include sectoral sanctions that target specific Belarusian industries and businesses, while Belarus's access to international financial markets is further restricted. In terms of their effect on the Belarusian economy, it is the sectoral sanctions imposed by the EU and the UK that are expected to have the strongest impact, as they envisage a ban (or restrictions) on the export of important Belarusian trade items, such as potash and petroleum products. According to estimates by Belarusian economists, these sanctions could have a negative effect on total Belarusian exports of between 10% and 13.5%. The potential cumulative macroeconomic losses from the sanctions – provided they are effectively enforced – could be between 6% and 10% of GDP over two years. However, as yet, solid evidence on the economic effect of the new sanctions is hard to come by; moreover, most sanctions were not introduced with immediate effect.

Aside from the worsening relations with the West, the overall external economic environment in the first half of the year was favourable to Belarus. Trade relations with Russia were restored (after the dispute over gas prices was settled in late 2020), and this contributed to a strong recovery of Belarusian exports. The higher international prices of hydrocarbons also benefited Belarus, which is a major exporter of petrochemicals.

GDP grew by 3.5% year on year in the first half year, but that was largely on account of the low base of the previous year. Gross industrial output in the first six months rose by 10.4% year on year, thanks to the resumption of oil and gas deliveries from Russia and the recovery of other trade flows. Exports of goods and services in the first half year soared, rising by 32.8% year on year in current dollar terms and significantly outperforming the recovery in imports.

Mirroring the dynamics of the trade flows, there was an upward shift in Belarus's current account balance, which is expected to turn positive for 2021 as a whole. This contributed to a certain easing of the chronic balance-of-payments constraints that Belarus has faced in recent years.

On the demand side, the recovery in the first half of 2021 reflects the upturn in private consumption and exports. In statistical terms, both private consumption and net exports made a significant positive contribution to GDP growth. By contrast, the decline in fixed investment continued and the contribution of gross fixed capital formation to GDP growth was largely negative. One should note, however, that the recovery in private consumption in this period needs to be judged against the very low base of the previous year. Furthermore, real disposable income in Belarus has remained stagnant since 2017.

Inflationary pressures have increased significantly in 2021, due to both imported inflation and rises in administered prices. In response to this development, the National Bank of Belarus has raised its policy rate, in two steps, from 7.75% at the beginning of the year to 9.25% in July. At the same time, overall monetary policy in 2021 can be considered lax, with the resumption on a massive scale of directed credit to state-owned companies by state-owned commercial banks. Such credit is equivalent to implicit subsidies to ailing state-owned firms, as the loans are extended on preferential conditions to loss-making firms that would otherwise have no access at all to credit on market terms. These transactions are sanctioned and tolerated by the central bank. On the one hand, they produce excessive money supply; on the other, they result in substandard and non-performing loans to state-owned firms. The latter effect is equivalent to the accumulation of quasi-fiscal deficit, which in time usually transforms into cash budget deficit. Past experience suggests that, in the medium term, such practices are a major source of Belarus's persistently high inflation.

The coronavirus situation worsened in early autumn. After several months of relatively low infection rates (between March and August), the number of daily new cases increased rapidly in September, reaching the highest levels since the start of the pandemic. The officially reported COVID-related death rate is still relatively low, but the reliability of the statistics remains questionable.

Probably the most important recent development in Belarus has been the move towards further economic integration with Russia. In September, the leaders of the two countries initialled 28 integration programmes, covering various spheres of economic life. In principle, this step can be regarded as part of the process of establishing the so-called Union State between Russia and Belarus under the treaty that the two countries signed back in 1997. That treaty set out an ambitious agenda of integrative economic measures, and also included security aspects referring to the joint territory of the two countries. However, the process of preparing and implementing this agenda has been very slow, and over the past decade Belarus has been reluctant to undertake concrete new commitments.

The situation changed radically after the events following the 2020 presidential election in Belarus. The brutal suppression of the protests against the alleged manipulation of the election led to the increased international political and economic isolation of Belarus. That, in turn, left its leaders with no choice but to seek support from – and closer ties with – their main ally, Russia. One of the consequences was the revival of the negotiations over the so-called ‘road maps’ for economic integration between the two countries.

The 28 integration programmes endorsed in September signal the two countries’ intention of moving towards the establishment of a common economic space. They cover some key spheres of economic relations, such as the coordination of macroeconomic policy, the unification of key energy markets (oil, gas and electricity), the coordination of industrial policy, the mutual liberalisation of public procurement, the harmonisation of labour legislation and social security, etc. Issues that were included on the initial Union State agenda, but that are notably absent from the September documents are the establishment of a common currency and a common parliament; these questions have been left to future negotiations.

So far, not much detail regarding the content of the 28 integration programmes has leaked into the public domain. Furthermore, the initialling of the programmes by the two leaders only marks one step in the process towards their formal adoption. Further steps will include the parliaments of the two countries deliberating on the programmes (which may prompt further negotiations and amendments) and their final formal signing at the top level. Nevertheless, the initial endorsement marks an important development in the process and suggests that some of the hurdles previously in the way have been cleared. Thanks to this rapprochement, Belarus is now hoping to receive fresh credits from Russia, which will ease the servicing of its foreign public debt.

Overall, the short-term outlook for the Belarusian economy has improved slightly since our spring forecast. The rate of GDP growth in 2021 may reach 2.5% for the year as a whole. As the growth in exports of both goods and services has outstripped the growth in imports, we expect a small positive current account balance for the year as a whole. If inflation continues to intensify, further policy rate hikes by the central bank are also possible in the remaining months of the year.

However, the favourable factors that prevailed in the first half of 2021 will probably not continue. Recent statistics suggest that even in the first months of the second semester, the pace of growth has been slackening. Moreover, the Belarusian economy is plagued by chronic structural problems, which will continue to weigh on its performance. It is difficult to imagine an upturn in domestic demand in the coming years, and so Belarus will most likely continue to rely on exports as the main growth driver. However, the negative effect of the Western economic sanctions and the continuing erosion of real disposable incomes by high inflation mean that there will be limits to the impact of these growth drivers. Given the constraints that Belarus is facing, sluggish economic performance will likely prevail in the short run, and GDP growth in 2022 and 2023 will probably be below the figure for 2021.

Table 4.2 / Belarus: Selected economic indicators

	2018	2019	2020 1)	2020	2021	2021	2022	2023
				January-June			Forecast	
Population, th pers., average	9,484	9,443	9,380	.	.	9,400	9,380	9,350
Gross domestic product, BYN m, nom.	122,320	134,732	147,006	65,990	78,465	164,200	180,800	197,900
annual change in % (real)	3.1	1.4	-0.9	-1.8	3.5	2.5	2.0	2.3
GDP/capita (EUR at PPP)	13,120	13,750	13,920	.	.	.	.	.
Consumption of households, BYN m, nom.	64,491	71,630	74,553	35,571	40,415	.	.	.
annual change in % (real)	8.0	5.1	-1.5	-1.0	3.8	3.5	2.5	3.0
Gross fixed capital form., BYN m, nom.	32,081	36,424	36,435	15,678	16,274	.	.	.
annual change in % (real)	4.4	6.2	-6.9	-1.1	-7.5	-5.0	0.5	1.0
Gross industrial production								
annual change in % (real)	5.7	1.0	-0.7	-3.1	10.4	5.0	3.0	3.0
Gross agricultural production								
annual change in % (real)	-3.3	2.9	4.9	3.7	-0.3	.	.	.
Construction industry								
annual change in % (real)	2.2	0.1	-4.6	3.4	-16.6	.	.	.
Employed persons, LFS, th, average	4,897	4,909	4,885	4,838	4,830	4,850	4,800	4,750
annual change in %	-0.1	0.2	-0.5	-1.4	-0.2	-0.7	-1.0	-1.0
Unemployed persons, LFS, th, average	245	213	206	210	205	202	205	208
Unemployment rate, LFS, in %, average	4.8	4.2	4.0	4.2	4.1	4.0	4.1	4.2
Reg. unemployment rate, in %, eop	0.3	0.2	0.2	0.2	0.2	.	.	.
Average monthly gross wages, BYN	971	1,093	1,251	1,187	1,367	1,400	1,560	1,720
annual change in % (real, gross)	12.6	7.3	7.4	8.8	5.9	3.0	3.0	3.0
Consumer prices, % p.a.	4.9	5.6	5.5	4.9	8.8	9.0	8.0	7.0
Producer prices in industry, % p.a. 2)	6.8	6.3	5.6	4.6	10.4	10.0	9.0	8.0
General governm.budget, nat. def., % of GDP								
Revenues	41.5	40.0	36.2	37.8	35.9	38.0	38.0	38.0
Expenditures	37.5	37.6	37.9	41.0	37.1	40.0	40.0	39.0
Deficit (-) / surplus (+)	4.0	2.4	-1.7	-3.2	-1.2	-2.0	-2.0	-1.0
General gov.gross debt, nat. def., % of GDP 3)	47.5	41.0	48.0	.	.	51.0	52.0	52.0
Stock of loans of non-fin.private sector, % p.a.	12.7	10.0	21.4	18.4	7.7	.	.	.
Non-performing loans (NPL), in %, eop 4)	5.0	4.6	4.8	5.1	5.0	.	.	.
Central bank policy rate, % p.a., eop 5)	10.00	9.00	7.75	8.0	8.5	10.0	9.5	8.5
Current account, EUR m 6)	20	-1,115	-221	-959	100	400	500	300
Current account, % of GDP	0.0	-1.9	-0.4	-3.7	0.4	0.7	0.9	0.5
Exports of goods, BOP, EUR m 6)	28,409	28,932	24,890	11,394	14,303	28,800	29,700	30,300
annual change in %	11.8	1.8	-14.0	-17.8	25.5	15.7	3.1	2.0
Imports of goods, BOP, EUR m 6)	30,536	32,684	26,637	12,414	14,694	30,100	30,900	31,600
annual change in %	8.9	7.0	-18.5	-18.3	18.4	13.0	2.7	2.3
Exports of services, BOP, EUR m 6)	7,511	8,628	7,704	3,741	4,013	8,500	8,600	8,900
annual change in %	7.3	14.9	-10.7	-3.0	7.3	10.3	1.2	3.5
Imports of services, BOP, EUR m 6)	4,594	5,237	4,287	2,009	2,217	4,700	4,900	5,300
annual change in %	7.5	14.0	-18.1	-12.4	10.4	9.6	4.3	8.2
FDI liabilities, EUR m 6)	1,212	1,139	1,220	1,208	941	1,300	.	.
FDI assets, EUR m 6)	47	-3	67	36	21	100	.	.
Gross reserves of CB excl. gold, EUR m 6)	4,561	6,265	3,604	5,324	3,837	.	.	.
Gross external debt, EUR m 6)	34,307	36,416	34,229	36,511	35,492	35,400	34,800	34,600
Gross external debt, % of GDP	67.3	63.1	64.9	69.3	62.7	62.5	59.7	57.7
Average exchange rate BYN/EUR	2.4008	2.3342	2.7888	2.5753	3.1010	2.90	3.10	3.30

1) Preliminary. - 2) Domestic output prices. - 3) Including publicly guaranteed debt. - 4) From 2018 doubtful, bad and small part of supervised assets; previously doubtful and large part of supervised assets. - 5) Refinancing rate of CB. - 6) Converted from USD.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.