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Belarusian Economic Research  
and Outreach Center



# Economic Outlook

Second Quarter 2017

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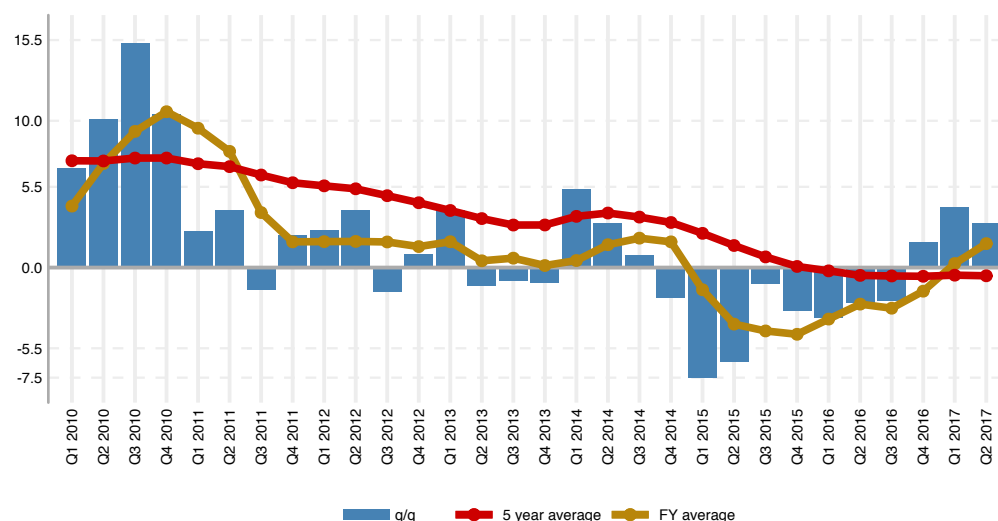
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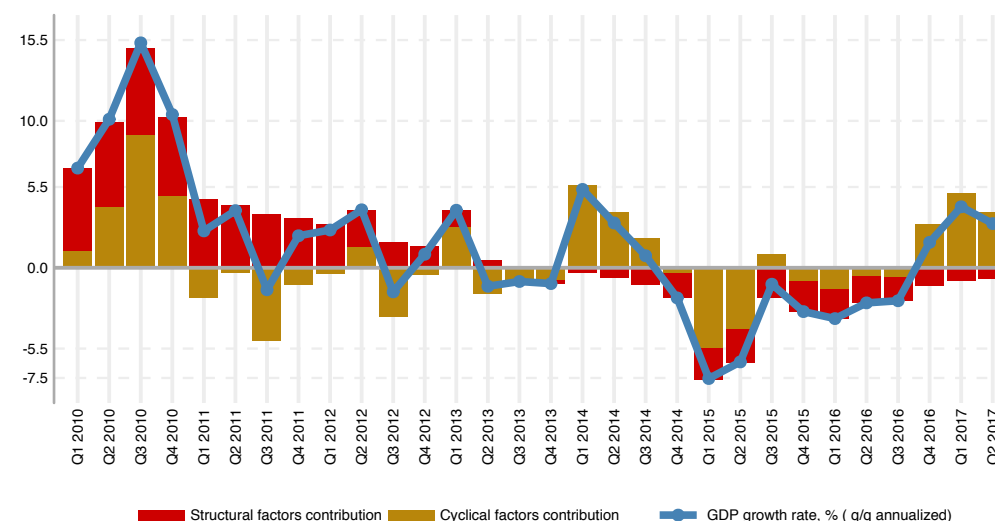
## Has Growth Hit Its Ceiling?

- Output growth continues, but the recovery is unstable.
- Consumption is growing, pulling imports.
- The pace of imports growth exceeds that of exports growth.
- Monetary policies are getting expansionary.
- The real exchange rate has hit its 5-year low.
- Real wages grow at a low pace, but disposable incomes are still shrinking.

GDP growth rate, %  
(seasonally adjusted, annualized)



Decomposition of GDP growth: the contribution of structural and cyclical factors, percentage points



1. By default Belstat reports GDP growth rates (i) on accrual basis and (ii) vs. the same period of a previous year. The series of such growth rates turn out to be flat, but it 'hides' new signals in output dynamics. In internationally accepted practice series of the annualized growth rates between two consecutive quarters (with a seasonal adjustment) are more frequently employed. Such growth rates reflect the tendencies of the output with respect to a particular quarter (including the last one). The series of annual average growth rates (not on accrual basis) allow to avoid high volatility of previously mentioned indicator and embeds the information about the last quarter to the previous year context. Finally, average annualized growth for last 5 years (not on accrual basis) could be viewed as indicator characterizing the environment of the long-run growth.

2. Decomposition of GDP to structural and cyclical component is made by means of univariate Kalman and Hodrick-Prescott filters. Final decomposition is a result of averaging of these two approaches. In terms of growth rates, such decomposition demonstrates contribution of structural and cyclical factors to growth rates of the output. However, it doesn't focus on the current state of the trend (potential) output and output gap (corresponding estimates of levels may differ significantly (than estimates of growth rates) in comparison to estimates based on another decomposition techniques).

## Main trends

### Fading Momentum of ‘Catching-up’ Recovery. Will There be New Determinants to Support Output Growth?

The output growth observed over the last three quarters can be labelled as “catching-up” or “recovery” growth. First, the lagged effect of adjustment to the changed environment was triggered: reduction of costs and other measures of rehabilitation of firms (2015-2016) gave some ‘head start’ to future competitiveness. As a result, starting from the second half of 2016, the extended period of export decline in volume terms gave way to export growth. Combined with the continued low demand for imports, it helped improve the net exports.

In the second place, in 2017 (specifically in the second quarter), some positive trends emerged in Belarus’ traditional external markets. Foreign counterparts started displaying ‘delayed’ demand for certain Belarusian goods, thus activating another channel of ‘catching-up’ export growth. This effect determined the growth of exports of potash fertilizers, as well as a range of capital goods to Russia.

In the third place, following a long period of decline, household consumption started growing in 2017. In this case, the effect of ‘delayed’ demand also played a role: longing to believe that the bottom of real incomes has been hit, households are restoring their consumption level of the ‘lush’ years. Thus, in Q1-2 2017, there was growth of final consumption. But the reverse side of that is import growth as for many households ‘normalization’ of consumption also means more imported goods in their consumer basket.

The output dynamics observed in the second quarter were determined by a mix of the above three effects: the first one was gradually fading, while the second and the third ones were strengthening. As a result, the output growth was formally determined by final consumption, while the contribution of net exports was close to zero. However, in view of the cause-effect relationships, the effect of ‘delayed’ external demand should be acknowledged as the key determinant of the output dynamics, while the role of consumption was largely off-set by the associated growth of imports.

The emerging old new ‘conflict’ between domestic demand and net exports clearly reflects the limited capacity and structural weaknesses of the economy. This ‘conflict’ results in limited potential growth driven by domestic demand. The potential sustainable growth driven by net exports is also limited: the ‘head start’ to competitiveness achieved through financial rehabilitation efforts in 2015-2016 has been practically used up. In this context, only new positive shocks to exports and/or local currency depreciation could support/reinforce the output growth for a while. But in the medium-term perspective, maintaining the status quo would not help break the extended period of stagnation.

## Informational background

### A Pause in Belarus-IMF Negotiations on a Stabilization Program

In July, the IMF officially announced that its negotiations with Belarus on a new program were put on hold. The program was expected to focus on structural reforms, and the Fund could provide quite significant resources on attractive terms to support such reforms. The IMF stated that the pause was caused by lack of support of the program by the top government officials. The main ‘stumbling stone’ of the negotiations was the divergence of the positions of the parties concerning state-owned enterprise sector reforms.

The status of the state-owned enterprise sector is currently the key challenge for Belarus’ economy. Without permanent state support, many large state-owned enterprises would be unable to ensure their sustainable functioning and generate profits, while the directed concentration of resources in this sector is transforming into an increasingly significant barrier to the development of efficient firms and the economy in general.

Therefore, the situation around the discussions with the IMF clearly illustrates that the authorities are still unprepared to reform the economic model itself, being forced to accept only some ‘cosmetic’ changes in it. Such a result of the long negotiations with the IMF would affect the country’s image and the perception of its economic prospects by foreign stakeholders.

### The National Bank Getting to Move to Inflation Targeting

In early 2017, the National Bank officially declared its plans to move from monetary targeting to inflation targeting in the medium term (by 2020). In contrast to similar pronouncements made over the previous 10 years, this declaration is supported with a plan of preparatory actions. Moreover, some of them were launch as early as in the second quarter. For example, important adjustments were made to the mandate of the National Bank – from now on, its sole declared monetary policy objective is the price stability. In addition, the range of powers of the National Bank was slightly expanded. Thus, the declared transition plan inspires certain confidence. And the gradual transition to the inflation targeting regime will create a favorable background for the operation of the country’s financial market.

### Authorities Aim to ‘Harness’ Trends in FinTech and IT Sectors

In the second quarter, the authorities announced the preparation of a new decree on the IT area. The decree will allegedly create the legislative framework for further development of the domestic FinTech and IT sectors. Another innovation in this field was the blockchain network developed by the National Bank to be used by the Belarusian banking system. Such initiatives create a favorable context for the development of the national economy. However, lack of transparency in developing new rules for the IT sector and its isolation from other sectors of the economy sparks widespread criticism.

## Output and demand

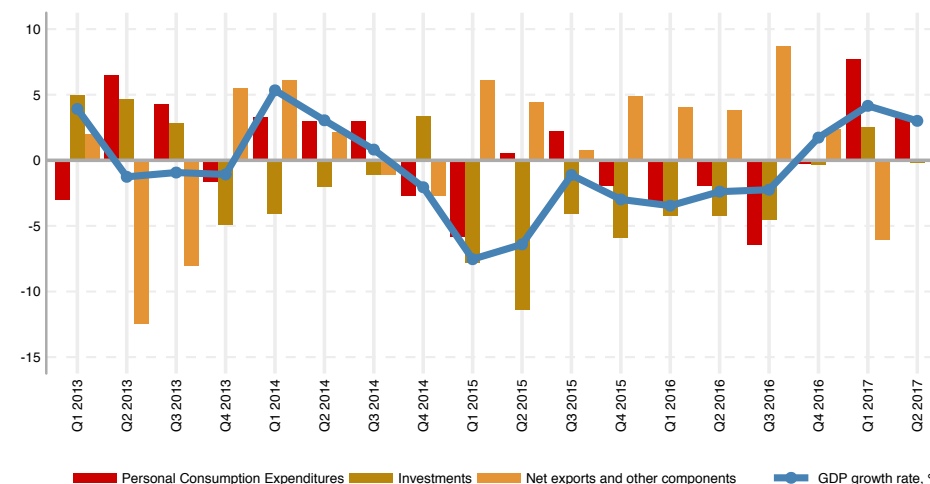
### Consumer Demand as Key Source of Economic Activity Impulses

In the second quarter, of the elements of demand, only household consumption demonstrated solid growth. The pattern of consumption followed that of real wages – both growing at a similar pace for two consecutive quarters. Such a fast and sensitive response of households to the modest income growth suggests that they feel that the period of ‘belt-tightening’ has lasted too long. However, such consumer behavior could only support the modest output growth as the contribution of other demand components was close to zero.

### Growth of Quality Indicators Continues, but its Nature is Contradictory

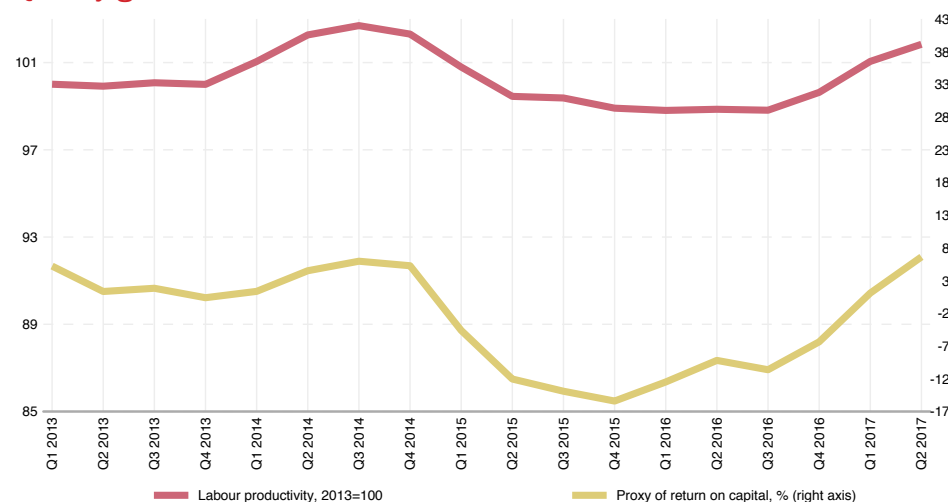
The quality indicators of the economic environment display further growth, but its interpretation is not straightforward. On the one hand, this growth reflects the discontinued practices of artificial support of excess employment and making ad hoc investments that is favorable for the economic environment. However, the labor productivity growth and return on capital are generated not so much through higher output, but through lower employment and investments. This reflects the structural weaknesses of the economy – a significant part of the resources could not be used efficiently and, thus, the best solution is not to use them at all.

Contribution to output growth, percentage points



Note: The growth rate of GDP is provided on annualized quarter on quarter basis with a seasonal adjustment; GFCF – gross fixed capital formation.

Quality growth indicators



Note: The proxy for the return on capital is calculated as the relationship between annual average output growth and share of GFCF in GDP.

## Monetary sector

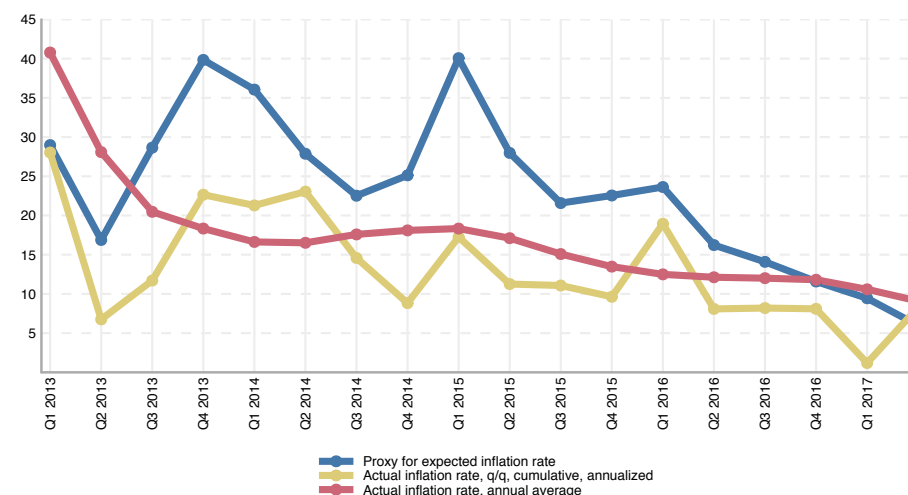
### Monetary Environment within Comfort Zone

The consumer price growth accelerated somewhat in the second quarter compared to the first quarter of 2017. But the quarterly (annualized) inflation remained at a single-digit level that is a success in Belarus' context. In addition, the specificity of this year in the seasonal price dynamics must have been a key factor contributing to the accelerated inflation. To put it differently, the medium-term trend of inflation deceleration continues. At the same time, the historically low inflation over the last year has also contributed to subsiding inflation expectations. In its turn, it is a prerequisite of maintaining low inflation rates in the short-term perspective.

### Monetary Policies Getting Increasingly Expansionary

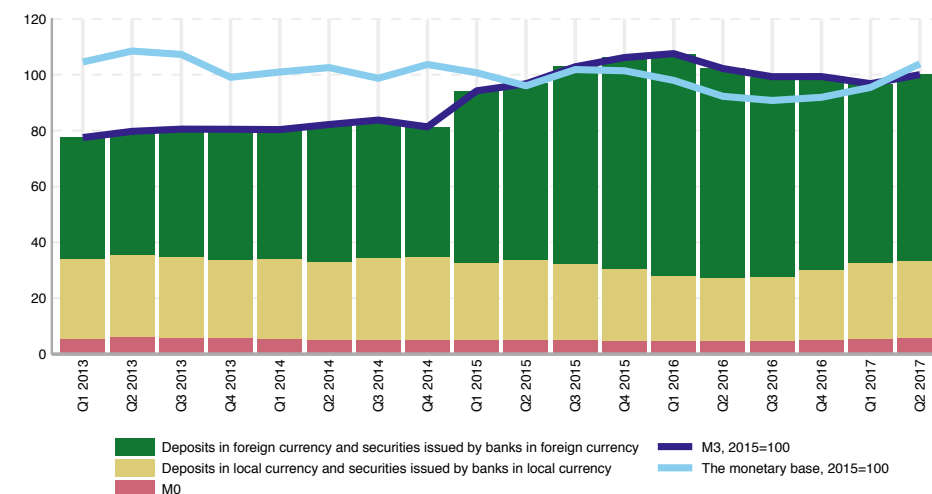
Having got to a comfort zone that is partly a result of its policies, the National Bank is trying to loosen its monetary policies and support the output growth path. To achieve that, it brought down the refinancing rate twice during the second quarter, while money supply indicators demonstrated strong growth, for the first time over a long period. However, while until early 2017 there were no doubts about the advisability of policy loosening, the situation in the second quarter was no longer so straightforward. Judging by a range of factors, monetary policies shifted from being constraining or neutral to being expansionary in the second quarter.

### Inflation and inflation expectations %



Note: Inflation expectation proxy is calculated as difference between interest rates of new savings deposits and call deposits for individuals.

### Monetary aggregates



Note: The components of Broad money (M3) correspond to the scale M3 in 2015=100. All the components are seasonally adjusted.

## Fiscal sector

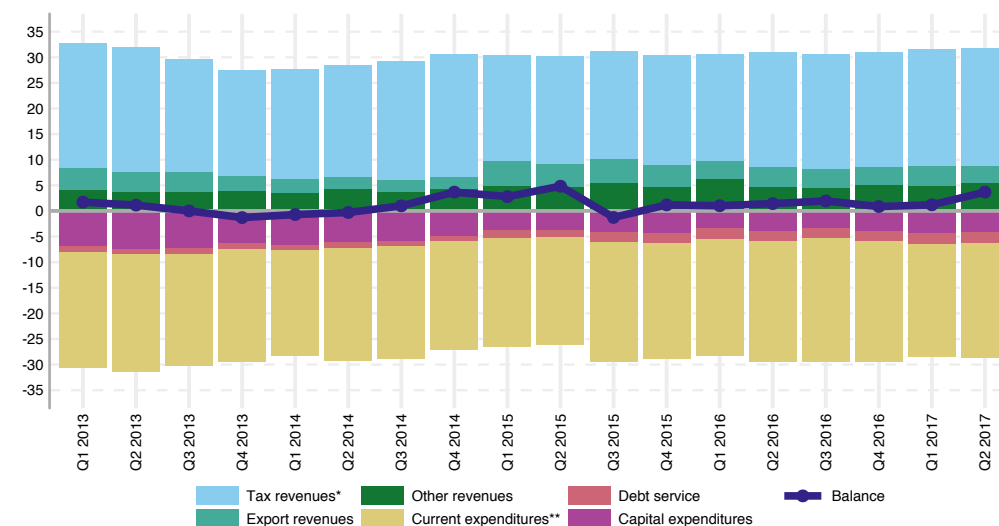
### Surplus Expansion through Non-Tax Budget Revenues

An important fiscal policy constraint is the need to execute the consolidated budget with a surplus to make public debt-related payments. In the second quarter, the surplus grew noticeably (by nearly 2.5% of GDP in annualized terms). The key reason was the impressive growth of non-tax revenues (covering revenues from state-owned assets, payments for government services, fines, etc.) and non-repayable receipts. This effect was somewhat off-set by the growth of current expenditures (by about 0.4% GDP in annualized terms) that was a result of the growth of salaries and wages, and social transfers in the context of the new wave of their directed reinforcement. As the non-tax revenue increase is unlikely to be sustainable, further directed growth of salaries and wages is seen as a challenge to fiscal sustainability.

### Public Debt Burden Growing Further

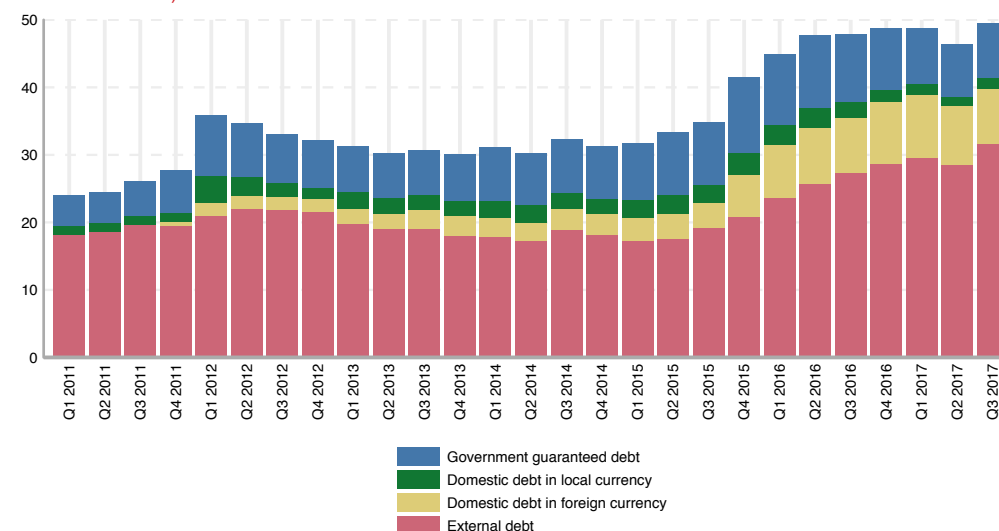
In the second quarter, the Government borrowed USD 600 million from the EFSD, and issued Eurobonds totaling USD 1.4 billion (of which USD 0.8 billion will be used in future to repay the previous Eurobond). These borrowings clearly illustrate the current situation – to meet their old liabilities, the authorities have to maintain / expand the public debt despite the need to reduce it in the interests of medium-term fiscal and debt sustainability.

### Consolidated budget performance, % GDP



Note: \* - without taxes on foreign trade; \*\* - without debt service. % GDP values are seasonally adjusted.

### Public debt, %GDP



Note: as of the beginning of the quarter.



## External sector

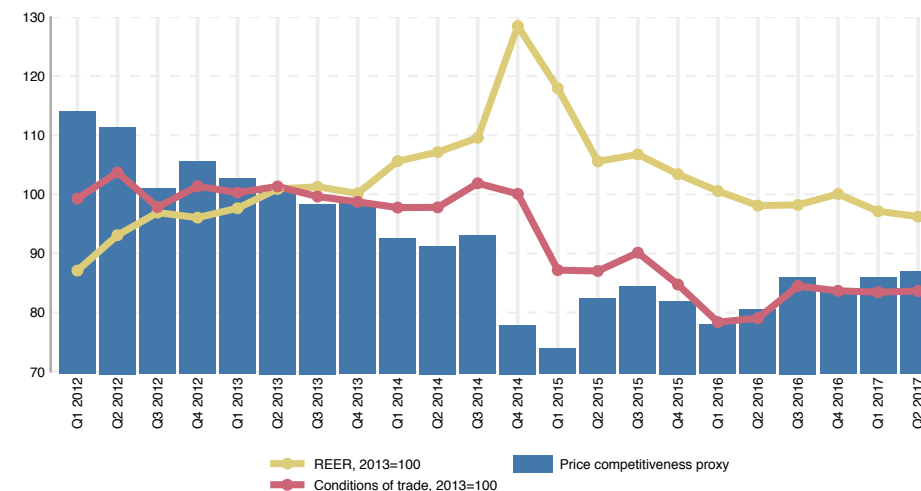
### Real Effective Exchange Rate at its 5-Year Low

In recent years, export and import prices followed identical trends resulting in no change in the terms of trade. In this context, the real exchange rate contributes to ensuring the price competitiveness of domestic firms. In small, but one-way moves, the real exchange rate depreciated, reaching its 5-year low. The exchange rate is likely to get entrenched within this range as the economy is now close to its external equilibrium. However, provided the import growth continues at a pace exceeding the rate of export growth (for example, due to excess domestic demand), the trend of the local currency real depreciation would persist.

### Global Economy Growth Heating up

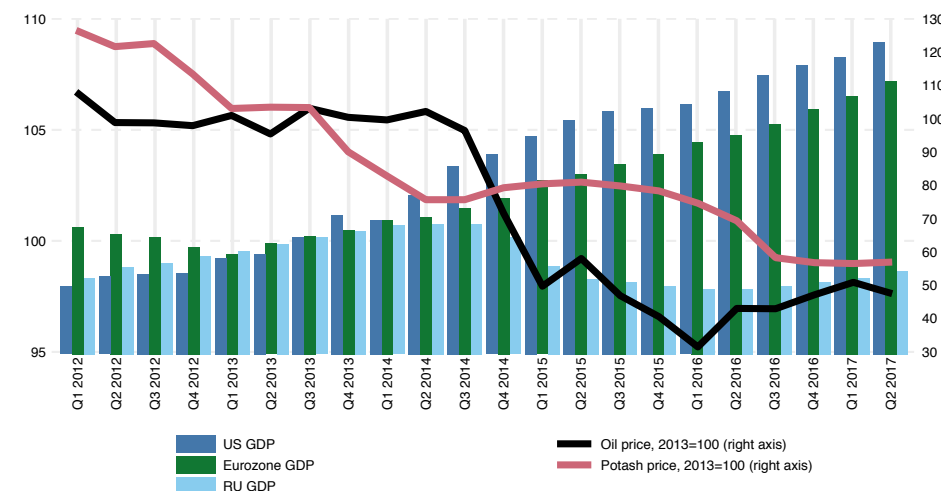
The largest economies of the world continued to display attractive growth rates in the second quarter, with growth accelerating in most of them. In the USA, the output growth went up in the second quarter to 3.1% in annualized terms (from 1.2% in the first quarter), in the Eurozone – to 2.3% (from 1.9% in the first quarter), and in China it remained at 6.9%. The growth revival backed the decision of the US Fed to raise its interest rate by 0.25 point (to 1-1.25% per annum) – already a second increase in 2017. The new wave of optimism supported the quite rapid growth in international stock markets observed since November 2016. In the second quarter, the key world stock indices grew by 2-6%.

External price competitiveness indices, 2013 = 100



Note: Price competitiveness index is calculated as the product of trade conditions index and reversed REER index multiplied by 100.

Global economic indicators, 2013=100



Note: All GDP indicators are seasonally adjusted. Potash and oil price indices are calculated based on corresponding data in the IMF IFS database.

## External operations

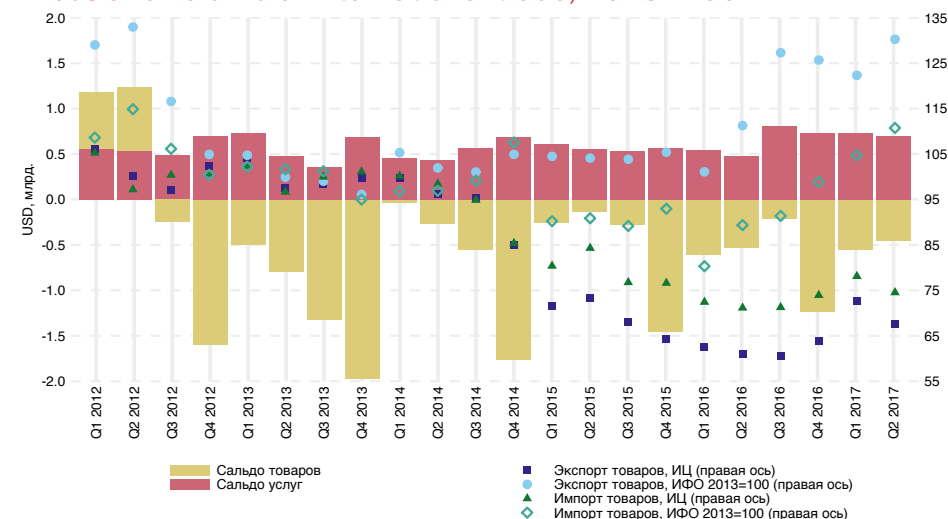
### Pervasive Imports Growth

In the second quarter, the rate of import physical volume growth accelerated further, clearly exceeding the rate of growth of export physical volumes. The physical volume of imports is growing for all consolidated commodity groups – investment, intermediary, and consumer goods. It shows that the propensity to import growth is engrained in economic agents' behavior. The impact of this trend on the trade balance and balance of payments in the second quarter was off-set by a leap in exports of certain goods (for instance, potash), as well as positive trends in the trade in services and the primary income path.

### Cheaper, but Still Expensive Borrowings in External Markets for Belarus

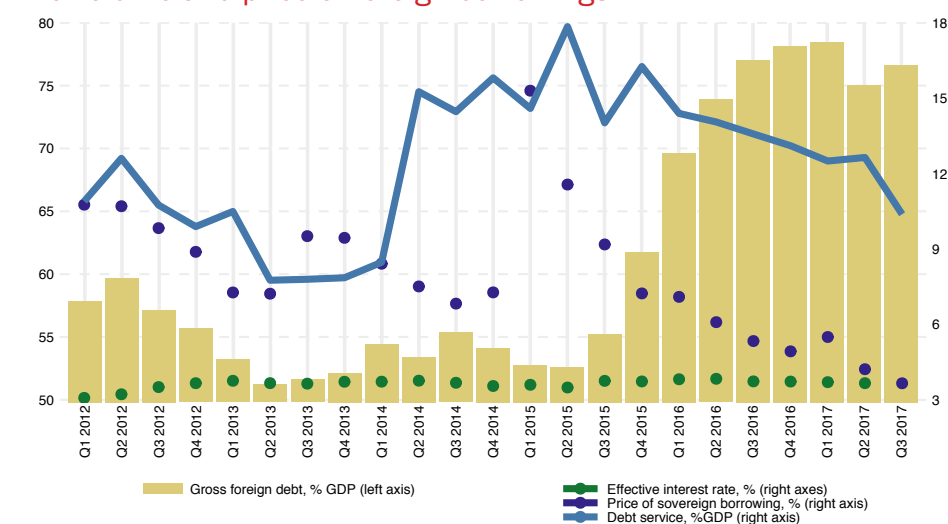
In June, Belarus issued two new Eurobonds totaling USD 1.4 billion – a 5.5-year one at 7.125% and a 10-year one at 7.625% annual. Compared to previous Eurobond issues, the cost of borrowings in external markets has declined for Belarus. However, the country's specific image and structural weaknesses in the economy prevented a further reduction of the cost of external borrowings. For instance, countries with identical ratings (Iraq) or lower (Ukraine) managed to mobilize resources on more favorable terms practically at the same time. The high cost of borrowings in external markets and their high share in the total debt will lead to a somewhat higher effective debt service interest rate in future.

Prices and volume of international trade, 2013=100



Note: PI – price index; PVI – physical volume index. Indices are seasonally adjusted. Balance of trade in goods and services are not.

The volume and price of foreign borrowings



Note: debt service includes interest and principal payments. Effective interest rate is calculated as a ratio of interest paid during past 4 quarters and average amount of debt in this period. Price of sovereign borrowing – an estimate of the yield to maturity on Belarusian Eurobonds 2018.

## Social sphere

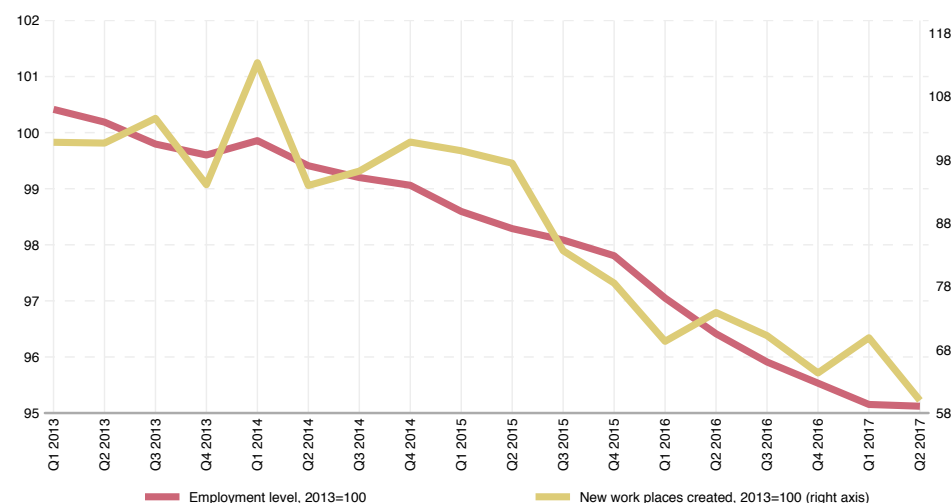
### Wage Growth Not Yet Leading to Household Disposable Income Growth

Following the protests last spring, the authorities got greatly concerned about employment and household incomes. The administrative measures taken resulted in some improvement of the labor market indicators, which, however, turned out to be short-lived. For example, one of the most important indicators – the number of new jobs – returned to its downward path and was at its new record low starting from the second quarter.

The authorities were more successful in influencing the real wage path. In the second quarter of 2017, wages grew by 3.7% against the second quarter of last year (or by 6.4% against the first quarter of 2017). The highest rates of wage growth were registered in industry (metallurgy, production of machinery and equipment, and production of vehicles). At the same time, the real wages in the budget-financed sector (education, medicine, welfare) were still declining.

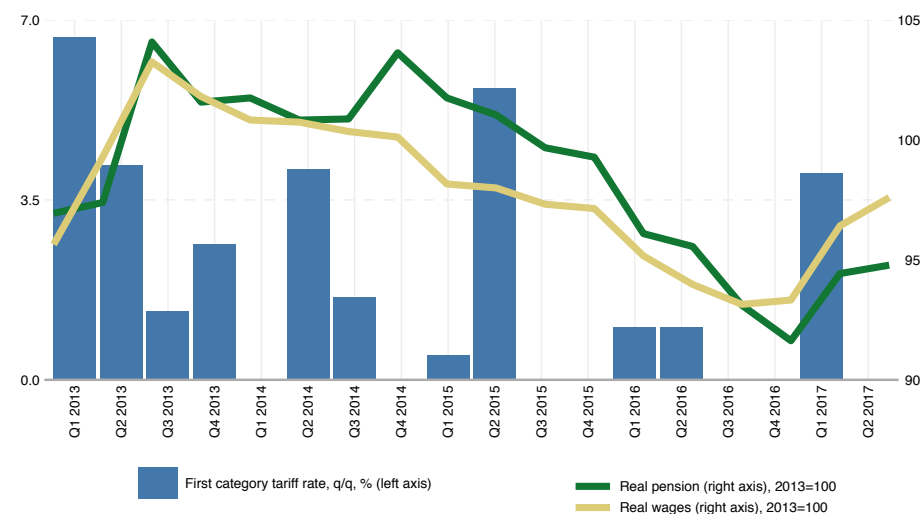
In the second quarter, the wage growth did not lead to growth of household real disposable incomes. This is largely a result of the low rate of growth of government transfers to households. Against the background of declining employment, pensions and benefits play an increasing role in household incomes. Incomes from entrepreneurship were also lagging behind the inflation growth. Therefore, poverty remains at quite a high level: in the second quarter of 2017, 5.9% of households lived below the poverty line (against 5.5% a year earlier).

### Employment and new working places



Note: Indices are seasonally adjusted

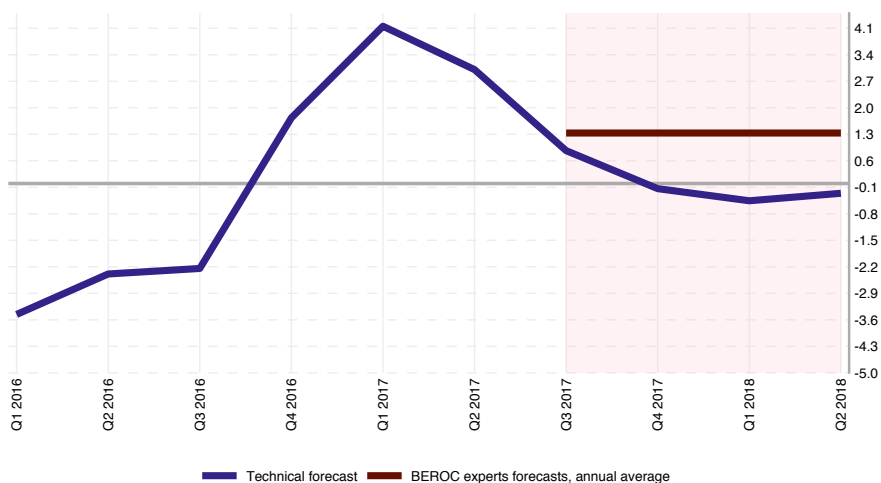
### First category tariff rate and households income



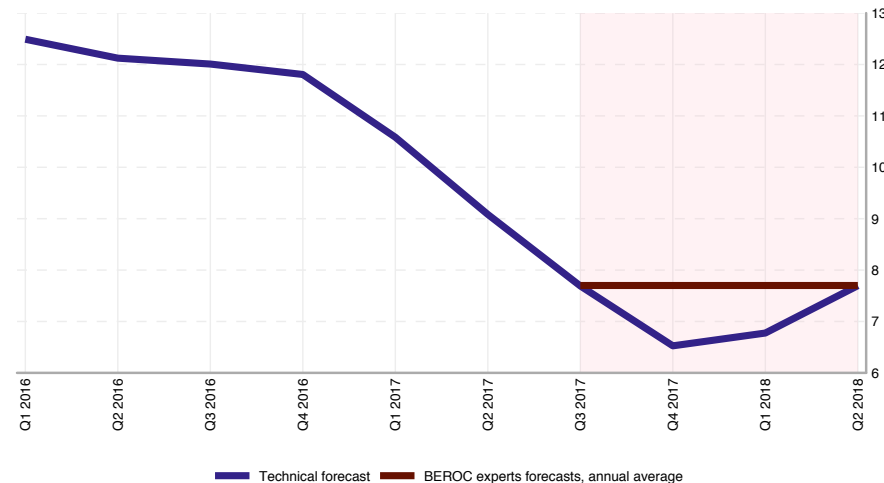
Note: Indices are seasonally adjusted

## Technical forecast

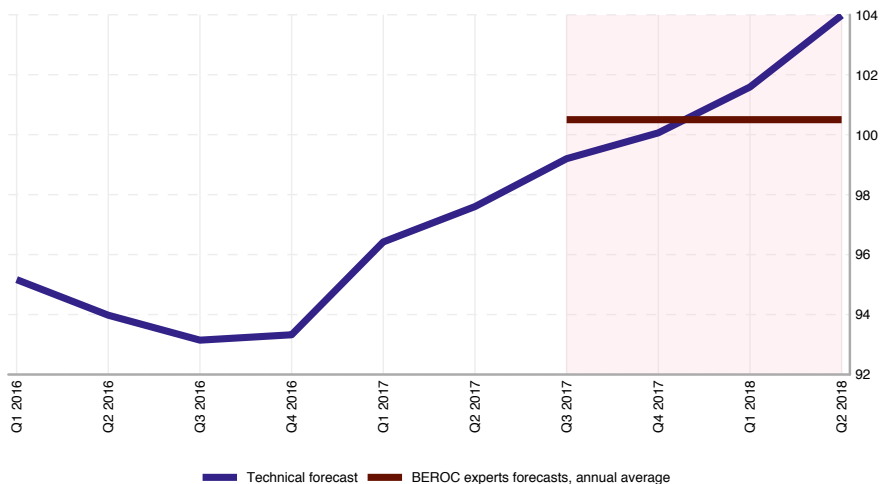
Output growth, quarter on quarter, % (annualized)



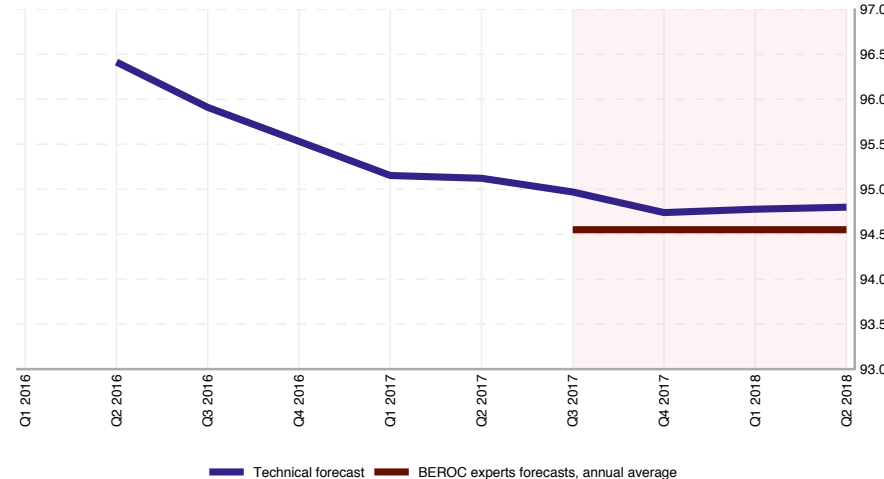
Inflation rate, annual average, %



Real wages, 2013 = 100



Employment, 2013 = 100



Technical forecast is an automated procedure that selects the best specification of ARIMA model for certain dataset based on Akaike information criterion (AIC) and employs this model for forecasting for 4 upcoming quarters. ARIMA-based forecast just takes into account past trends of selected indicator and doesn't consider other factors, neither in the past nor in the future. "Technical" forecast means that it doesn't include any linkages between economic indicators and is fully based on statistical methods. To correctly interpret this type of forecast one should use it as an answer to the following question: "what would happen with a particular indicator in a short-run period provided that inertial scenario is applied. That is, in case fundamental parameters of economic environment don't change, exogenous factors don't impact the environment and fiscal and monetary policies don't change either".

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International Monetary Fund ([www.imf.org](http://www.imf.org))

R Core Team (2016). R: A language and environment for statistical computing. R Foundation for Statistical Computing, Vienna, Austria. URL <https://www.R-project.org/>.

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