

Economic conditions at mid-year: Light at the end of the tunnel

The Belarusian economy seems to show some signs of recovery: After real GDP decreased by 3.9% in 2015 and experienced another drop by 2.6% in the last year, the first quarter of 2017 showed surprisingly good results (0.3% yoy change). Especially manufacturing profited from the increased external demand. Additionally, the increase and stabilisation of the commodity prices positively contributed to the development. It seems that positive expectations about the solution of the oil and gas conflict with Russia have been another positive factor. The dispute had hampered economic development in the comparable periods of the previous year. This was the case especially in the oil industry, which is of great importance for the country.

However, growth projections for the total year 2017 are still negative, as domestic demand remains too weak after incomes have decreased.

Even if the economy will finally return to growth in the next year, one should not be too optimistic. The low projected growth of 0.6% is rather of cyclical nature; substantial reforms would be necessary for a real growth trend.

2016 in retrospective

In the last year, real GDP decreased by 2.6% compared to 2015. This result is better than in 2015 (-3.9%), but still signals a strongly recessionary economic environment.

The year 2016 has been influenced by three negative events. Firstly, Russia strongly limited the supply of crude oil in the middle of the year in the context of the bilateral conflict about oil and gas between Belarus and Russia. In consequence, output of the oil industry decreased by ca. one third, which had a negative impact on GDP and caused a decrease in state revenues from duties on oil exports. Secondly, low commodity prices were the reason for the weak performance of exports, which also negatively affected GDP and revenues from export duties. Thirdly, demand for Belarusian goods remained low due to the continued recession in Russia. As a low level of diversification remains a characteristic feature of Belarusian exports, weak Russian demand had a strongly negative effect on total demand.

Outlook for 2017-2018

The following table provides an overview over the development of the most important economic indicators for 2017 and 2018.

Selected economic indicators 2016-2018

	2016	2017*	2018*
Real GDP growth, % change yoy	-2.6	-0.8	0.6
Inflation, % change yoy (annual average)	11.8	9.3	8.7
Current account, % of GDP	-4.3	-4.7	-5.0
Budget deficit, % of GDP ¹⁾	-4.6	-8.2	-7.7
Gross government debt, % of GDP	52.3	58.0	63.1

Sources: IMF, Belstat

*Estimations/Projections

Note: ¹⁾ Including Social Security Fund

Real sector/GDP

In the first quarter of 2017 GDP growth was positive for the first time in the last two years (0.3% yoy). Growth was driven by the manufacturing sector, which profited from the increased export demand. External demand increased by 23.5% yoy in the first quarter of 2017. Manufacturing grew by 5.1% compared to the first quarter of 2016. One should take into account that this happened at a time, when the important oil industry collapsed by 32%. The reason for this were limited oil supplies from Russia in the context of the bilateral dispute about oil and gas, which had started the year before. As the conflict was solved in April this year for the time being, it can be assumed that the oil industry will also start contributing to growth in the second quarter of 2017 instead of hampering it. Other growth sectors on the supply side are transportation, mining and agriculture.

However, these positive factors should not distort the general picture. Low domestic demand remains a break on growth. Decreasing real wages and the rise in unemployment depress consumption. Weak demand from the state sector further aggravates the situation.

Thus, over the full year economic performance will decrease for the third time in a row, although significantly less than in the previous two years. According to current projections, the economy will grow in the

coming year 2018 (0.6%) thus putting an end to the recession of the last three years.

Inflation

Inflation will be one-digit in the next two years (2017: 9.3%, 2018: 8.7%). Currently it amounts to only 6.3%. Thus, inflation shows a negative trend for several years in a row, which is to be assessed highly positively. The National Bank's policy aiming at maintaining monetary stability proves to be successful. The large volume of directed lending remains a challenge to monetary policy. On the one hand, the unrestricted growth of such credits has an inflationary impact and thus should be closely monitored. First steps in this direction have been undertaken, but continuation of that path is necessary. On the other hand, such credits prevent the creation of a level playing field in credit financing, which results in a disadvantage for private enterprises and puts a break on private sector growth. Another challenge for monetary policy is the latent risk of administrative price or wage increases.

Current account

The current account deficit will grow slightly in the next two years – to 4.7% of GDP in 2017 and 5% of GDP in 2018. This development is neither negative nor alarming in itself, but should be observed closely.

Government debt and budget deficit

If one looks at the projections for the budget deficit as defined by the IMF, then a significantly higher deficit can be expected in this year and the following year compared to 2016: 8.2% and 7.7% respectively after 4.2% in the last year. No improvement can be seen here and fiscal consolidation remains the only alternative. Thus, gross government debt as share of GDP will increase further. In the past years, depreciation of the Belarusian rouble had contributed to the expansion of the debt ratio, as a share of government debt is denominated in foreign currency. Consequently, currency risks play an important role for future projections.

Conclusion

After a surprisingly positive first quarter of 2017, the economic cycle seems to have bottomed out and the recession may be overcome by the end of the year. This trend has been caused by slightly increased and stable commodity prices on the world market and an increase in demand for exports. Whether it will continue depends on the further development of external demand and whether Russia will supply crude oil as agreed. At the same time, the economic recovery should not lead to exaggerated expectations.

For a substantial growth trend in the long perspective, which is especially important after the economic crisis during the last years, substantial reforms are inevitable.

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