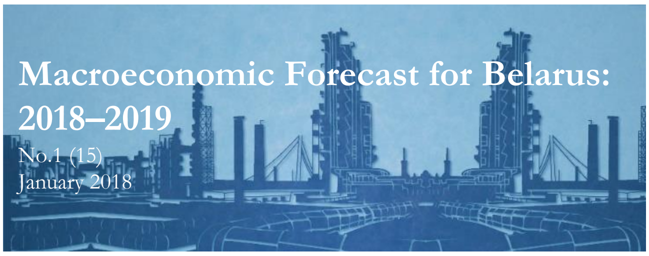

Macroeconomic Forecast for Belarus: 2018–2019

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Summary

- The economic recovery outpaced the most optimistic forecasts: according to our estimates, real GDP in 2017 went up by 2.3% yoy, 3.9% yoy in 2017Q4. The unexpected impetus came from domestic demand side – fast investment and household consumption recovery in the second half of 2017.
- Short-term global outlook does not anticipate any serious risks; moreover, current trends in commodities prices could bring better prospects for Russian economy and Belarusian exports. However, additional stimulus from the real depreciation is unlikely, which makes exports growth slower.
- Oil exports will hardly increase considerably, as it looks like Belarusian side prefer to keep refining at the economically efficient level and receive custom duty from the unrefined crude oil (up to 6 mln t as agreed with Russian side). Additional revenues may amount up to USD 700 mln annually.
- We expect real GDP growth in 2018-19 around 3% yoy with domestic demand as a main driver. Macroeconomic policies will remain balanced in order to keep inflation and imports under control: domestic demand recovery will lead to import increase and higher current account deficit.

Macroeconomic forecast for Belarus: The key figures

	2015	2016	2017		2018		2019
			Jan 2018	Jul 2017	Jan 2018	Jul 2017	Jan 2018
Real GDP growth, % yoy	-3.8	-2.5	2.3↑	*1.4*	3.0↑	*2.0*	2.9
Inflation, annual average, % yoy	13.5	11.8	5.9↓	*7.1*	5.6↓	*6.7*	5.2
Real wages growth, % yoy	-2.9	-3.9	5.1↑	*4.0*	6.7↓	*7.8*	6.0
Employment growth, % yoy	-1.2	-2.0	-1.2↑	*-1.8*	-1.0↑	*-2.3*	-1.7
Wages, annual average, BYN/month	671.6	721.9	803.6↓	*804.9*	905.5↓	*925.7*	1010.2
Exports of goods and services, USD bn	32.8	29.9	36.2↑	*34.8*	39.2↑	*38.0*	40.5
of which 'oil' exports	10.4	6.7	8.9↑	*8.2*	11.1↑	*9.9*	11.4
Imports of goods and services, USD bn	32.7	30.0	36.4↑	*34.0*	40.3↑	*36.7*	42.1
of which 'oil' imports	8.9	7.1	9.2↑	*7.9*	10.7↑	*8.5*	11.2
Memorandum items:							
GDP, BYN bn	89.9	94.9	104.7↓	*107.8*	117.8↓	*122.8*	130.8
GDP, USD bn	56.4	47.7	54.2↓	*56.4*	58.6↓	*60.3*	63.1

Note. For 2017 and 2018, two versions of the forecast are compared (current and previous baseline). All calculations were made based on the data available as of January 9, 2018.
Source: actuals (2015–2016) – Belstat, own calculations based on Belstat and NBB data; forecast – IPM Research Centre.

Abbreviations used:

Belstat	National Statistical Committee of Belarus
bn	Billions
CPI	Consumer price index
EIA STEO	United States (US) Energy Information Administration, Short-Term Energy Outlook
GDP	Gross domestic product
IFS	International Financial Statistics
IMF	International Monetary Fund
IPM RC	IPM Research Centre
mln	Millions
NBB	National Bank of Belarus
REER	Real effective exchange rate
Rosstat	Russian Federal State Statistical Service
yoy	year-on-year (annual growth rate)
WEO	World Economic Outlook
Standard symbols for metric units and ISO currency codes are used.	

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Data sources/references:

Belstat, http://belstat.gov.by/.
EIA STEO, https://www.eia.gov/outlooks/steo/outlook.cfm.
Eurostat, http://ec.europa.eu/eurostat/data/database.
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NBB, http://nbrb.by/.
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Model estimates and forecasts are performed in EViews 10+. Figures are plotted in EViews 10+.

Executive editor:

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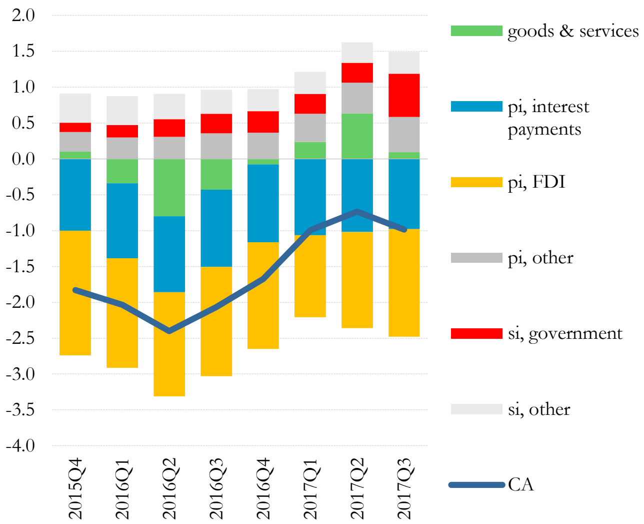
Recent trends[1]

In the end of December 2017, Belstat revised national accounts data for 2016 (final revision) and for the 2017Q3 (second revision). According to the update, real GDP in 2016 fell by 2.5% yoy (2.6% before the revision), and increased by 2.9% yoy in 2017Q3 (2.8% yoy before the revision). According to our estimates, in 2017Q4 real GDP will go up by 3.9% yoy, and annual growth will reach 2.3% yoy comparing to 1.7% yoy planned in the official forecast made in December 2016. Fast recovery was due to the faster than expected domestic demand growth, both of household consumption and investment. According to the revised data, in 2017Q3 household consumption went up by 5.9% yoy (partially due to low base effect), gross fixed capital formation – by 8% yoy. Further growth prospects will depend on sustainability of domestic demand recovery.

Second important trend of 2017 was very fast disinflation: inflation fell from 11.5% yoy in January 2017 to 4.6% yoy in December, while the NBB's target was inflation not higher than 9% eop. Consistent monetary policy, absence of shocks from the exchange rate side and slow growth of housing and utilities tariffs contributed to this record fast disinflation; in its turn, it helped to reduce interest rates and improved access to credit.

Figure 1. Current account balance, 4-quarter moving sum, USD bn



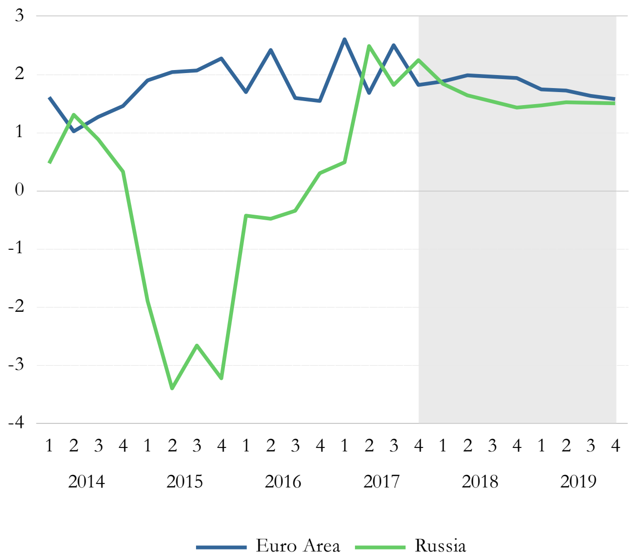
Note. CA – current account balance; "pi" stands for primary income; "interest payments" – other investment, interest; "FDI" – direct investment; "si" – secondary income; "government" – general government.
Source: NBB.

Other important changes came from the balance of payments side. In the 2017Q3, net secondary incomes of the general government amounted to record high USD 402.6 mln (USD 72.5 mln in 2016Q3), see Figure 1. Origins of this hike can be related to the latest agreements regarding the oil trade between Belarus and Russia. Several times highest officials of both countries mentioned that (i) in 2017 Belarus will import 24 mln t of oil, or 6 mln per quarter, and (ii) that 6 mln t of this volume will be re-exported to collect the custom duties to the Belarusian budget. However, for the first three quarters we imported just 13.6 mln t, or 4.4 mln less than planned. Custom duties that would have been collected from re-export of these 4.4 mln t are approximately equal to USD 350 mln, i.e. it looks like Russia transferred this amount to Belarus. Depending of the Belarusian oil products exports and crude oil price, Belarus could collect up to USD 600–700 mln next year through this channel, which will reduce the burden of the interest payments on external debt (around USD 1 bn annually).

Assumptions

This time we estimated only baseline scenario: it is hard to formulate other probable scenarios. First, it seems that there is a consensus about conservative macroeconomic policy (with gradual partial institutional improvements). Second, in the global economy short-term risks are "broadly balanced"[2]. Any major risks are so uncertain and difficult to quantify that their modelling would be purely speculative and voluntary. Thus, this macroeconomic forecast is based on the assumption of conservative monetary policy envisaged by the Main Directions of Monetary Policy for 2018, and moderate forecasts of economic growth, inflation, and exchange rates in the main trading partners, as well as real price for crude oil of around 57–58 USD/bbl (2014 constant prices) and real price for potash fertilizers around 350-360 USD/t of K2O. Evolution of the respective indicators is provided on the Figure 2 (real GDP growth in Russia and Euro Area) and Figure 3 (a: inflation, and b: exchange rate indexes of Russian Rouble and Euro, and crude oil price index).

Figure 2. Real GDP growth rates in Russia and Euro Area, % yoy



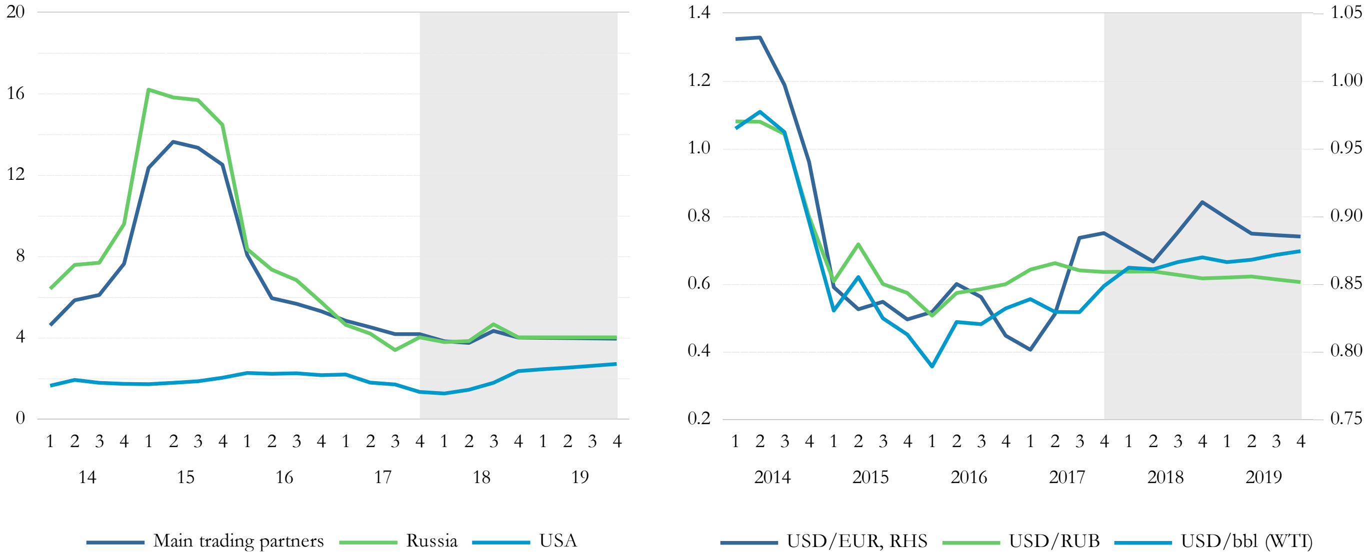
Source: actuals (2014Q1–2017Q4) – Eurostat for Euro Area (19 countries), Rosstat for Russia; forecast – own calculations based on the WEO Database, October 2017.

Inflation in main trading partners (see Figure 3a) is taken from the WEO October 2017 database without changes; exchange rates (Russian Rouble) and crude oil price were significantly revised in order to make them closer to the actual figures for 2017Q4. The 'oddity' is that we expect simultaneous increase of crude oil nominal price in 2018-19 and slow depreciation of the Russian Rouble (see Figure 3b). RUB exchange rate projections were made based on the consensus forecasts of the HSE Development Centre (Russia) – although it does not take into account expected increase of crude oil price, any voluntary revision of the exchange rate may be less grounded than taking its forecast as purely exogenous. Comparing to the previous issue of the forecast, we excluded the IMF's commodities price index from the model, as the IMF stopped publishing it (last available data is for June 2017).

[1] Recent macroeconomic trends were summarized in the bulletin "Macroeconomic update: Sources of economic growth, 2017Q3".

[2] See IMF (2017). "Seeking Sustainable Growth: Short-Term Recovery, Long-Term Challenges", World Economic Outlook, October 2017.

Figure 3. Prices and key exchange rates



(a) Price indexes, % yoy **(b) Exchange rates and crude oil price**

Note. Main trading partners are weighted by the REER weights.
Source: actuals (2014Q1–2017Q4) – Index Mundi (WTI monthly price) and IFS database (other indicators); forecast – own calculations based on the WEO Database, October 2017 (exchange rates (except Russia) and price indexes), HSE Development Centre (RUB/USD exchange rate), and EIA STEO, January 2018 (WTI price).

Regarding the volumes of energy imports, we expect that Belarus will purchase 20 mln t of crude oil and 3 mln t of oil products from Russia both in 2018 and 2019. This would allow to increase oil products exports to 14 mln t + 1.5 mln t of exports of bituminous mixtures or similar non-taxable good, see Table 1.

Table 1. Prices and volumes of 'oil' trade

	Prices				Volumes			
	2016	2017	2018	2019	2016	2017	2018	2019
'Oil' imports								
2709	218.7	289.0	349.1	359.4	18157.1	18599.1	20000.0	20000.0
2710	329.0	337.8	403.9	414.2	1718.7	3100.0	3000.0	3000.0
2711	136.6	146.2	130.4	142.6	18.6	19.3	19.5	19.7
'Oil' exports								
2709	291.7	371.7	464.1	478.9	1616.6	1621.7	1632.2	1633.4
2710	310.8	440.7	526.8	543.6	13018.6	12760.6	14058.7	14058.7
2715	221.0	275.8	328.9	339.4	376.8	1425.4	1562.1	1562.1
3104	354.6	353.1	381.6	395.9	5706.3	6200.0	6269.4	6269.4

Note. HS codes: 2709 – crude oil, 2710 – oil products, 2711 – natural gas, 2715 – bituminous mixtures, 3104 – potash fertilizers. Gas prices are in USD per 1000 m^3, others are in USD per t. Volumes are in bn m^3 for gas, thousand t for the rest.
Source: actuals – Belstat; forecast – IPM Research Centre based on EIA STEO, January 2018.

The rationale of these figures is as follows. First, representatives of Belarus several times mentioned that processing of 18 mln t is the most effective in terms of profitability of processing. Second, Russia agreed that Belarus will collect custom duty from up to 6 mln t of Russian crude oil exports. Thus, higher imports reduce transfer of custom duties for the difference between oil imports for processing and agreed 24 mln t of total crude oil imports; however, lower oil imports reduce oil products production (and real GDP growth rate), that is why we expect increase of crude oil imports to 5 mln t quarterly. Natural gas imports, according to our estimates, exceeded 19 bn m^3 in 2017 and will go up slowly in 2018 and 2019, following economic growth. In terms of exports volumes, we expect that exports of potash fertilizers will be close to the production frontier (like in 2017), and stood at this level in 2018-19. Details are presented in the Table 1.

Concerning prices, crude oil price (market) is projected based on the actual price for the beginning of January 2018, futures price for mid-February 2018 (source – Index Mundi), and further change in EIA STEO monthly forecast (January 2018). Prices for other commodities from the Table 1 are linked to the oil price; price for imported crude oil is set as a difference between the market price for Urals oil (linked to WTI price projections) and custom duty calculated based on the existing formula[3].

Forecast[4]

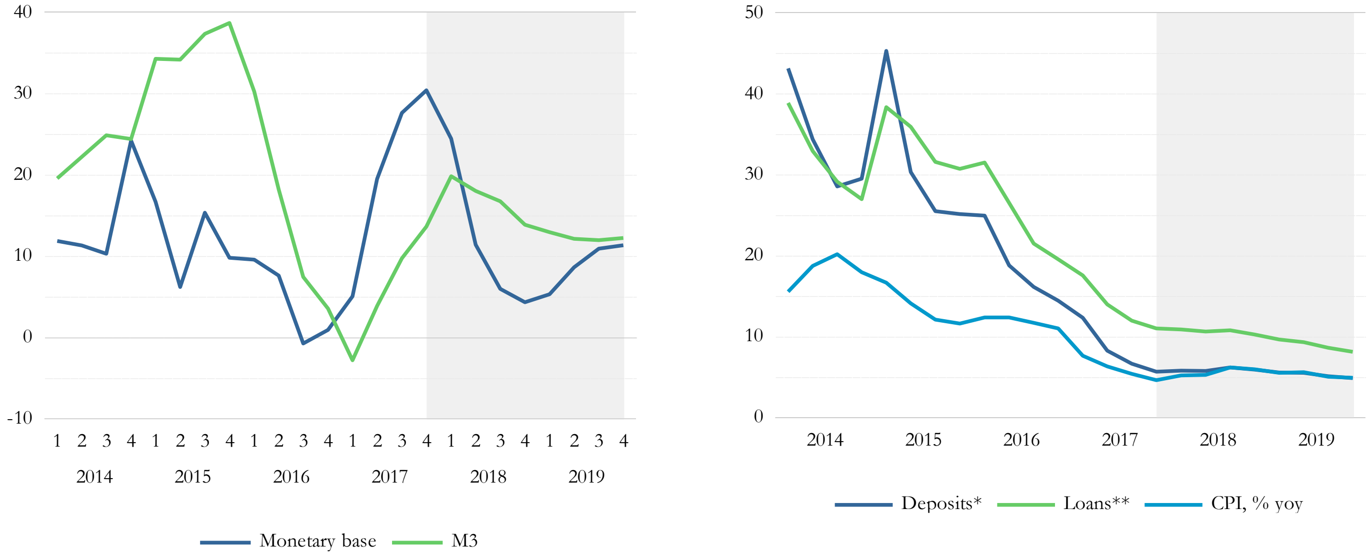
The forecast was made based on the macroeconometric model built in EViews 10+ based on the quarterly data from 1995Q1 (some equations – from 1998Q1 or 2000Q1) to 2017Q3. Only baseline scenario described above was estimated.

Monetary policy (all variables are endogenous – monetary base, broad money supply, and interest rates) will remain conservative. End of period growth rate of M3 will be kept in the interval envisaged by the Main Directions of Monetary Policy for 2018 (see Figure 4a). Disinflation will allow further reduction of interest rates: rouble time deposits interest rate will be slightly above the inflation rate, the gap between rouble loans interest rate and time rouble deposits will gradually decrease from 5.3 percentage points in the end of 2017 to 4.3 percentage points in the end of 2018 and 3.3 percentage points in the end of 2019, see Figure 4b. According to our estimates, *inflation* will stay close to 5% yoy, slightly increasing from the record low 4.6% yoy in the end of 2017 to about 5.6% yoy in the end of 2018 and then decreasing to 4.9% yoy in the end of 2019 (Figure 4b). Of course, faster or slower increase of utilities prices or any exchange rate shock can influence inflation, but

[3] Customs duty, USD/t = 29.2 + 0.3·(oil price, USD/t – 182.5).
[4] The preliminary version of this forecast was presented at the seminar "Economic environment in Belarus – 2017", organized by the IPM Business School in cooperation with BEROC and IPM Research Centre on December 20, 2017. The forecast was revised and extended for 2019 after the national accounts data update by Belstat made in the end of December, 2017 (quarterly data for 2016 – first 3 quarters of 2017 was revised), as well update of the data on balance of payments, Russian real GDP, and crude oil price.

the impact of both channels is now limited: the share of housing and utilities in household consumer expenditures is less than 10%, while elasticity of inflation on the nominal exchange rate (against US Dollar) is now less than 0.2. Without major shifts in monetary policy, Belarusian inflation will converge to inflation in its main trading partners (see Figure 3a).

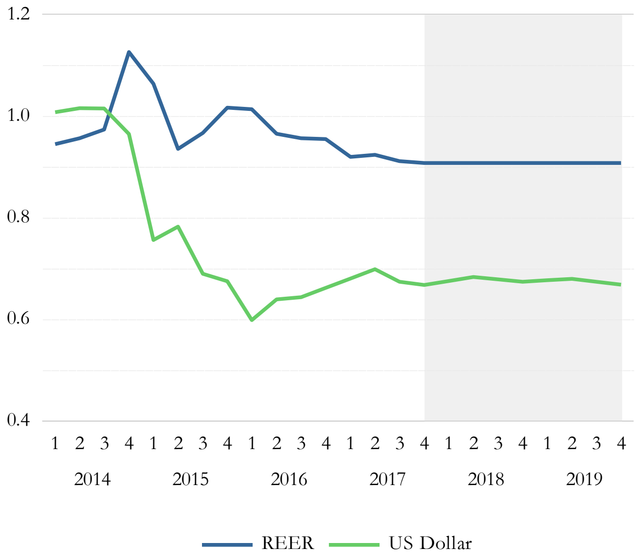
Figure 4. Selected monetary policy indicators, baseline scenario



(a) Money supply, growth rates, % yoy **(b) Interest rates (% per annum) and inflation**

Note. * – new time household deposits in BYN; ** – new loans in BYN (interbank loans are not included).
Source: actuals (2014Q1–2017Q4) – NBB; forecast – IPM Research Centre.

Figure 5. Real exchange rates (effective and against the US Dollar), baseline scenario, indexes, 2014 = 1

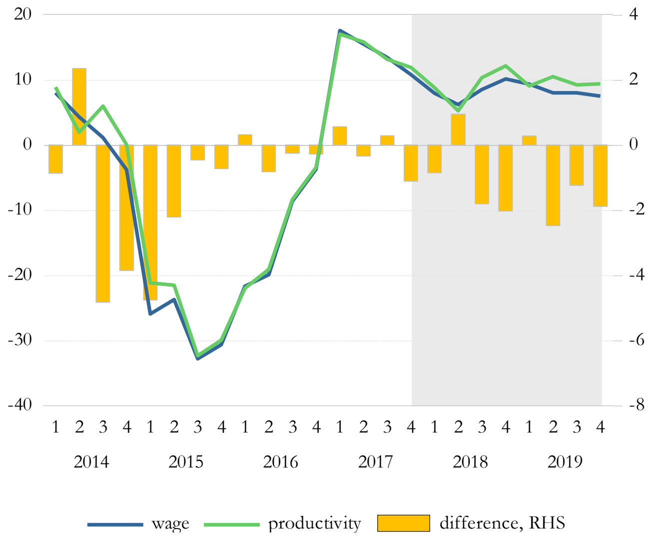


Source: actuals (2014Q1–2017Q4) – own calculations based on the NBB/Belstat/IFS data; forecast – IPM Research Centre.

We assume that real effective *exchange rate* (REER) will stay at the level of 2017Q4[5] (see Figure 5). As inflation in Belarus will stay slightly above those in the main trading partners, while the IMF and Russian forecasters do not expect significant depreciation of the Belarusian main trading partners' currencies, depreciation of Belarusian Rouble will remain moderate: according to our estimates, Belarusian Rouble (currency basket) will depreciate by 3.7% yoy (1.5% eop) in 2018 and by 2% yoy (1.5% eop) in 2019.

Assumptions about the real effective exchange rate and expectations about slow growth in main trading partners pre-determine slower growth of non-oil exports and decrease of its contribution to real GDP growth from the expected 4.5 percentage points in 2017 to modest 0.7 and 0.5 in 2018 and 2019, respectively (see Table 2). As a result, non-oil imports growth will go down too: we expect that its contribution will decrease from -4.3 percentage points in 2017 to -2.3 and -0.9 in 2018 and 2019, respectively. Positive contribution will come from the oil exports side in 2018 (see Assumptions for explanations). Overall impact of oil trade in 2018 will be positive (0.7 percentage points). Net exports contribution will stay between -1 and 0, thus, according to our forecast, economic growth potential in 2018-19 will be related to domestic demand dynamics.

Figure 6. Growth rates of USD-denominated wages and labour productivity, % yoy*



Note. * difference between wage and productivity growth rates is in percentage points.
Source: actuals (2014Q1–2017Q4) – own calculations based on the Belstat/NBB data; forecast – IPM Research Centre.

[5] According to our estimates, this correspond to the annual current account deficit of 2.1% of GDP. Nominal exchange rate is forecasted based on this 'equilibrium' REER, inflation in main trading partners, and exchange rates of the main trading partners against the US dollar.

Table 2. Real GDP and aggregate demand forecast

	2012	2013	2014	2015	2016	2017	2018	2019
Growth rates, % yoy								
Real GDP	**1.6**	**1.0**	**1.7**	**-3.8**	**-2.5**	**2.3**	**3.0**	**2.9**
Domestic Demand	*2.0*	*8.0*	*-0.2*	*-7.6*	*-5.4*	*2.9*	*4.1*	*3.5*
Household consumption	10.9	10.8	4.3	-2.4	-3.2	3.4	4.1	3.3
Gross fixed capital formation	-11.5	9.0	-5.8	-15.5	-14.5	2.4	8.1	6.2
Other domestic demand components	11.1	-1.5	-1.6	-8.2	4.5	1.7	-2.3	-0.2
Exports of goods and services ('non-oil')	7.8	-3.0	-0.5	-7.0	15.9	10.9	1.7	1.1
Imports of goods and services ('non-oil')	9.6	13.5	0.1	-12.7	3.0	10.8	5.3	2.0
Exports of goods ('oil')	15.2	-33.4	17.6	11.1	-17.5	5.8	6.7	0.0
Imports of goods ('oil')	16.3	-35.1	5.5	6.7	-13.1	11.5	3.7	0.0
Contribution to real GDP growth, percentage points								
Domestic Demand	*2.0*	*7.7*	*-0.2*	*-7.7*	*-5.3*	*2.7*	*3.9*	*3.4*
Household consumption	4.6	5.0	2.2	-1.2	-1.7	1.8	2.2	1.8
Gross fixed capital formation	-4.4	3.0	-2.1	-5.1	-4.2	0.6	2.1	1.7
Other domestic demand components	1.7	-0.3	-0.3	-1.3	0.7	0.3	-0.4	0.0
Net exports of goods and services + stat discrepancy	*-0.3*	*-6.8*	*1.8*	*3.8*	*2.7*	*-0.4*	*-0.9*	*-0.4*
Exports of goods and services ('non-oil')	2.8	-1.2	-0.2	-2.5	5.5	4.5	0.7	0.5
Imports of goods and services ('non-oil')	-3.3	-5.1	0.0	5.3	-1.1	-4.3	-2.3	-0.9
Exports of goods ('oil')	3.3	-8.1	2.8	2.1	-3.8	1.1	1.3	0.0
Imports of goods ('oil')	-3.1	7.6	-0.8	-1.0	2.1	-1.6	-0.6	0.0

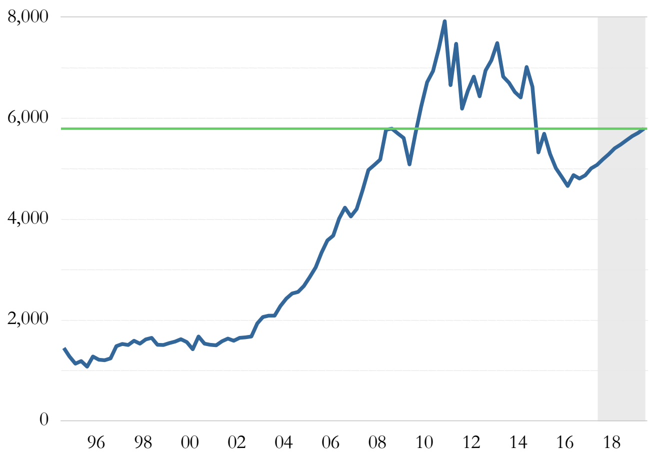
Source: actuals (2012–2016) – Belstat/own calculations based on Belstat data; forecast – IPM Research Centre.

According to our estimates, real household consumption will grow with the rate around 3–4% a year (see Table 2), following productivity-driven wage growth (nominal wage growth will stay below nominal productivity growth rate for 7 of 9 forecasted quarters) – we expect that real wages will go up by 6–7% in 2018-19. Faster real wage growth is due to the gap between GDP deflator and CPI: according to our estimates, GDP deflator will increase by 9.2% yoy in 2018 and 7.9% yoy in 2019 comparing to 5.6 and 5.2% yoy of CPI-measured inflation, respectively. Employment will go down by 1% in 2018 and 1.7% in 2019. Faster decline in 2019 is mainly due to demographic reasons: first, according to the UN projections, working-age population (15–64) will shrink by 0.9% yoy in 2018 and by 0.93% yoy in 2019, second, its structure will deteriorate: the share of pre-pension/pension age population (55–64) will go up in 2 years by 0.6 percentage points to 21.4% of working age population, while the share of 25–34th years old will fall by 0.7 percentage points to 22.2%. As a result, according to our forecast, employment rate (employment divided by the working age population[6]) will fall from 67.2% in the end of 2017 to 66.2 in the end of 2019.

Investment recovery is expected due to the increase of real money supply and further decrease (although gradual) of interest rates. In 2019, we also expect a tiny recovery of general government spending that may support public investment. According to our forecast, investment will go up by 8.1% in 2018 and 6.2% in 2019 (see Table 2), but even with these rates they will reach only the level of 2009 (or 2015), see Figure 7). At this stage, investment recovery largely depends on macroeconomic stability: while overall economic activity is rather weak, removal of macroeconomic risks supports some investment activity.

In summary, we expect faster economic growth than before (and faster than most of the other forecasters) due to the better performance of domestic demand. Others may underestimate potential for household consumption increase due to the underestimated potential for real wage growth. For instance, according to our estimates, in 2017, real wages grew 1.5 percentage faster than real labor productivity, but totally due to the difference in deflators: nominal wage increased by 11.3% yoy, nominal labor productivity – by 11.6% yoy. If to forecast real wage growth based on real productivity growth, then it should not be expected that it will grow by more than 4.1% yoy in 2018 and 4.7% yoy in 2019 comparing to our forecast of 6.7 and 6% yoy, respectively. But even in our case nominal wages will increase by 1 and 1.4 percentage points slower than nominal labor productivity in 2018 and 2019, i.e. unit labor costs will decrease, and forecasted real wage growth should not undermine price competitiveness or macroeconomic stability.

Figure 7. Real gross fixed capital formation, BYN mln



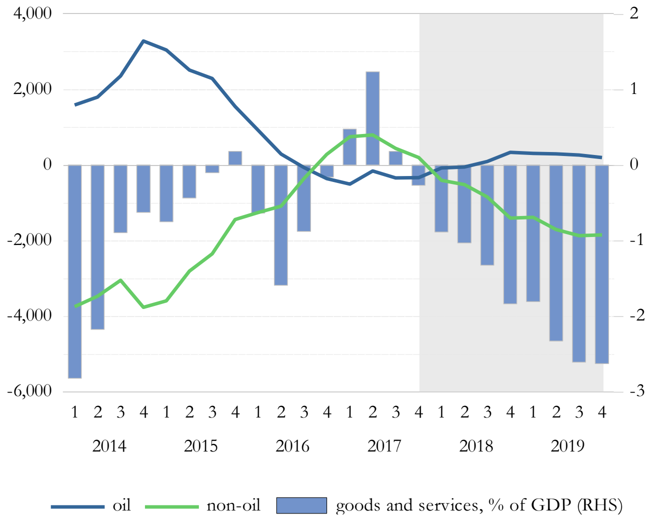
Note. Seasonally adjusted data in constant 2014 prices, denomination of 2016 is taken into account. Horizontal line stands for 2019Q4 value.
Source: actuals (1995Q1–2017Q4) – own calculations based on the Belstat data; forecast – IPM Research Centre.

However, faster domestic demand growth will lead to gradual deterioration of the current account: according to our estimates, goods and services trade deficit will increase from estimated USD 145 mln in 2017 to USD 1 bn in 2018 and USD 1.6–1.7 bn in 2019, see Figure 8. But having in mind the expected transfer of customs duty from crude oil re-export, overall current account deficit should not exceed USD 2 bn in 2018 and USD 2.3 bn in 2019 (3.2 and 3.6% of GDP, respectively). This is above the 'normal' 2.1% of GDP of current account

[6] Working age population – UN data (World Population Prospects).

deficit expected in 2017, that is why the government should focus its efforts not only on macroeconomic stability, but also on non-price competitiveness of Belarusian exports.

Figure 8. Trade balance, goods and services, 4-quarter moving sum, USD mln



Source: actuals (2014Q1–2017Q3) – NBB/own calculations based on Belstat and NBB data; forecast – IPM Research Centre.