Macroeconomic Update: Sources of economic growth, 2017Q3

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Summary

- The recovery is on the way: in 2017Q3, real GDP went up by 2.8% yoy, in Oct-Nov 2017 – by 4.6% yoy (own estimates based on Belstat data). It looks like economic growth in 2017 will overpass the most optimistic forecasts made in 2017.
- Drivers of growth in 2017Q3 changed from non-oil exports to domestic demand and oil exports. As a result, imports growth accelerated, and net exports contribution to real GDP growth turned negative for the first time since 2013.
- Factors that drove non-oil exports growth have almost gone: further real depreciation of Belarusian rouble is hardly possible due to limited disinflation potential, while Russian growth is too weak and volatile to be strong driver of Belarusian exports.
- The authorities should not try to 'support' growth by softer macroeconomic policies if next year it will be weaker than expected: as non-oil imports is very sensitive to domestic demand dynamics, and any artificial boost of consumption or investment may soon lead to a currency crisis.

Macroeconomic trends in Belarus

	2015	2016	2016Q4	2017Q1	2017Q2	2017Q3
Real GDP growth, % yoy	-3.8	-2.6	-1.9	0.4	1.7	2.8
Inflation, annual average, % yoy	13.5	11.8	11.0	7.6	6.3	5.4
Real wages growth, % yoy	-2.9	-3.9	-3.9	1.3	3.9	6.6
Employment growth, % yoy	-1.2	-2.0	-2.3	-2.0	-1.3	-1.0
Wages, annual average, BYN/month	671.6	721.9	747.4	735.9	797.1	834.4
Exports of goods and services, USD bn*	32.8	29.8	29.8	31.1	32.5	33.9
of which 'oil' exports*	10.4	6.7	6.7	6.9	7.4	7.9
Imports of goods and services, USD bn*	32.7	29.8	29.8	31.0	32.0	33.9
of which 'oil' imports*	8.9	7.1	7.1	7.4	7.6	8.3
Memorandum items:						
GDP, BYN bn*	89.9	94.3	94.3	95.9	98.2	101.5
GDP, USD bn*	56.4	47.7	47.7	49.3	51.1	52.9

Note. All calculations were made based on the data available as of November 30, 2017. * quarterly figures are moving sums for last 4 quarters.
Source: Belstat, NBB, Ministry of Finance; own calculations based on Belstat, NBB, and Ministry of Finance data.

Abbreviations used:

Belstat	National Statistical Committee of Belarus
bn	Billions
CPI	Consumer price index
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
SOE	State owned enterprise
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/.
Eurostat, http://ec.europa.eu/eurostat/data/database.
IFS database, http://data.imf.org/?sk=5DABAFF2-C5AD-4D27-A175-1253419C02D1&sId=1390030341854.
NBB, http://nbrb.by/.
Ministry of Finance of Belarus, http://minfin.gov.by/.
Rosstat, http://www.gks.ru/.
WEO database, April 2017, https://www.imf.org/external/pubs/ft/weo/2017/01/weodata/index.aspx.

Figures are plotted in EViews 10+.

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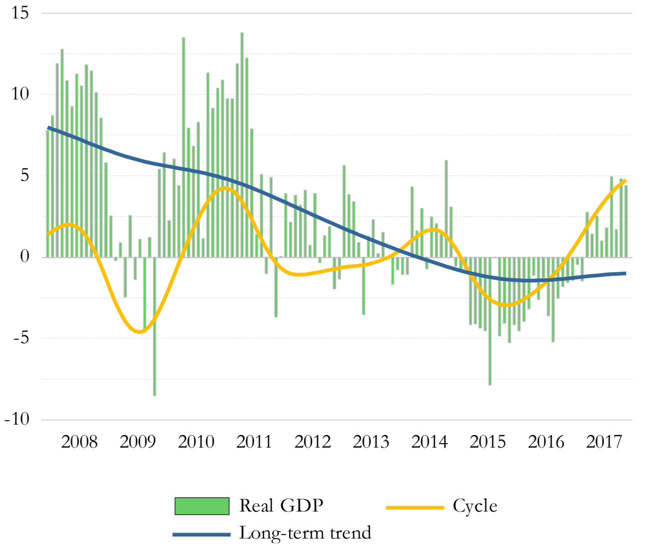
Economic growth[1]

Economic recovery is on the way: real GDP went up by 2.8% in 2017Q3, and the authorities are optimistic about the next year, expecting real GDP growth by 3.5% in 2018. According to our estimates based on Belstat data, for several recent months (August, October, and November), real GDP growth rates were close to 5% yoy (see Figure 1), and at this background the official forecast looks not so unreasonable. However, according to the decomposition of real GDP (monthly data, last observation November 2017), current growth is totally due to the cyclical factors (and it seems that we are close to the cycle's peak), while long-term trend growth rate is still negative, although its decline decelerates gradually. Moreover, more and more recent estimates give higher long-term growth rate, i.e. further data may show better stance of the long-term prospects of the economy.

Figure 1. Trend and cycle in real GDP, growth rates, % yoy



Note. Hodrick-Prescott decomposition was applied. To decompose the real GDP on the trend and the cyclical component, a smoothening parameter was estimated based on a filter frequency equal to 90 months for the long-term trend, and to 24 months for the cycle. Data is plotted for the last 120 months.
Source: own calculations based on Belstat data.

In the second and third quarters of 2017, real GDP was growing faster than expected[2] (mainly because of the faster than expected growth of potash fertilizers exports, household consumption growth, and slower than expected non-oil imports growth in the 2017Q2). Taking into account the forecast errors for the second and third quarters, our rough estimate for 2017 is 2.1% yoy comparing to initial 1.4% yoy and official forecast of 2% yoy.

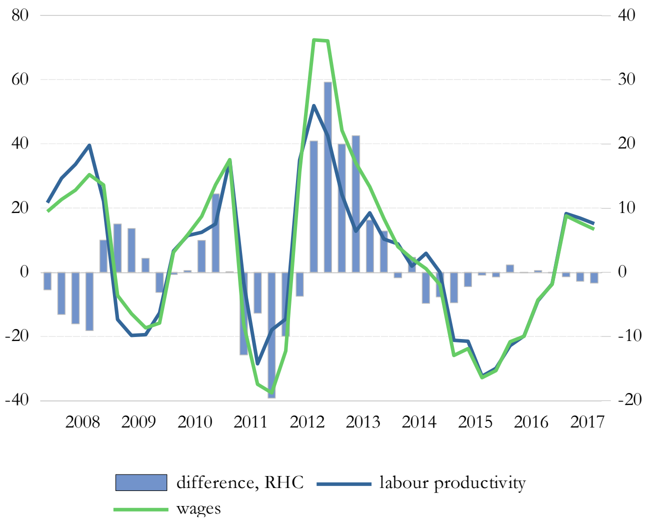
Domestic demand

Economic recovery of the last two quarters was driven by recovery of domestic demand, both household consumption and investment: according to our estimates, in 2017Q3, their contribution to real GDP growth amounted to 2.9 and 1.9 percentage points, respectively (see Annex, Table 1).

Household consumption

Real household consumption in 2017Q3 went up by 5.5% yoy (partially due to the low-base effect) against the background of fast real wage growth (+6.6% yoy) and slower employment decline (in 2017Q3, employment fell by 1% yoy, in 2017Q2 – by 1.3, in 2017Q1 – by 2% yoy). Fast growth of consumer crediting also contributed to the household consumption recovery. Between January and September 2017, banks issued BYN 1.4 bn of new short-term loans (with maturity up to 23 months) comparing to BYN 1 bn in the same period of 2016, i.e. increased from the amount equal to 2.75% of household consumption in Jan-Sep 2016 to 3.49% in the same period of 2017. It is important that fast growth of wages went in line with productivity growth: in 2017Q3, nominal wage growth was 1.7 percentage points slower than nominal productivity growth, see Figure 2. Even in October, growth rates of USD-denominated wages and productivity were almost equal (13.4 and 13.7% yoy, respectively), and keeping these two indicators balanced is one of the major factors behind the current macroeconomic stability[3].

Figure 2. Wages and labour productivity (measured in USD), growth rates, % yoy



Note. Labour productivity is calculated as GDP per one employed in the economy. Data is plotted to the last 40 quarters.
Source: own calculations based on Belstat and NBB data.

Investment

After long-lasted contraction, investment finally started to recover. Seasonally adjusted real gross fixed capital formation reached its bottom in 2016Q3; in 2017Q3, investment for the first time since 2013 went up – by 8.4% yoy. However, the only component of investment financing that demonstrates steady recovery is bank loans (loans from foreign banks and commercial loans of Belarusian banks) – and here macroeconomic stabilization is playing important role, allowing lower interest rates to households and companies. Investment financed by the government are recovering unevenly – local budgets' capital expenditures are growing, while central budget's ones are falling (apart from financing of nuclear power plant construction). Investment financed from own resources of household are stagnating – after some recovery in the second half of 2016 – first

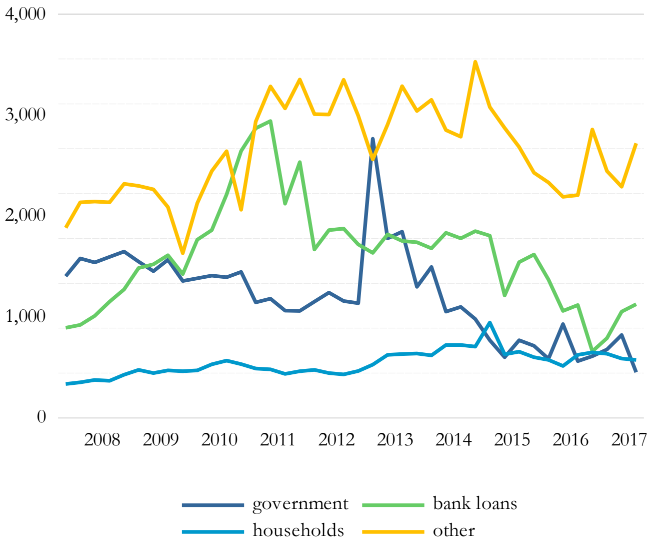
[1] More detailed information about the recent economic trends are available in the presentation "Economy of Belarus: The recovery has begun. What's then?".

[2] See IPM Research Center (2017). Macroeconomic Forecast for Belarus, 1(14), July 2017.

[3] See World Bank "Belarus: Increasing Productivity for Reviving Economic Growth and Incomes", World Bank economic update on Belarus, December 6, 2017.

half of 2017, they fell in the 2017Q3. Other sources of investment financing (major source – own resources of enterprises) tend to recover (Figure 3), but very unevenly and without clear fundamental factors behind[4]. After all, potential of further investment recovery is limited by the low attractiveness of the economy to foreign investors, and high debt burdens on the budgets and SOEs, and by overall capacity of the economy to recover (which will determine employment, productivity, and income dynamics).

Figure 3. Gross fixed capital formation, main sources of financing, BYN mln in constant prices of 2014*



Note. Other sources include own funds of enterprises, loans from non-financial organizations, and other sources, and calculated as a difference between total investment and sum of investment financed by the government (central and local budgets), via bank loans, and by households. Seasonally adjusted data. * Denomination of 2016 is taken into account.
Source: own estimates based on Belstat data on gross fixed capital formation and sources of fixed capital investment financing.

External demand

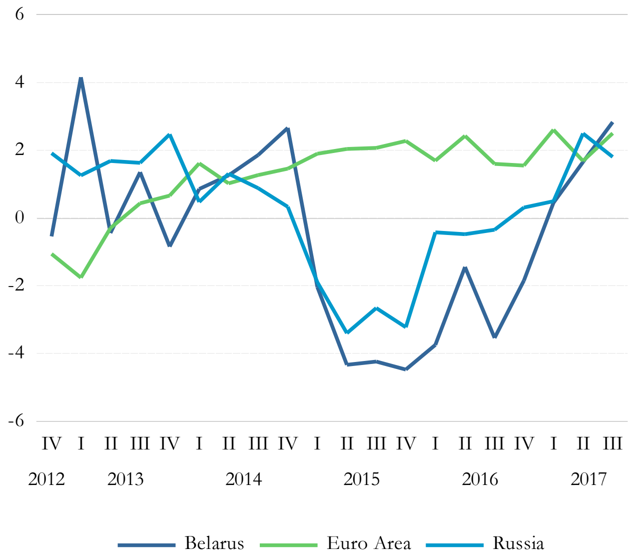
Extraordinary high contribution of 'non-oil' exports[5] to economic recovery of the second half of 2017 and the first half of 2017 is over – non-oil exports is still growing, but at much slower pace: according to our estimates, in 2017Q3 its contribution to real GDP growth fell to 2.2 percentage points from more than 9 percentage points in 2016Q4 and 2017Q1. At the same time, 'oil' exports started to grow (mainly due to low-base effect): according to our estimates, its contribution went up from around -6 percentage points in the second half of 2016 – 2017Q1 to +3.4 percentage points in 2017Q3 (see Table 1).

Recovery of imports continues, driven by domestic demand growth. For the first time after the recession, non-oil imports increased more than non-oil exports (Table 1). Taking into account the fact that contribution of oil imports growth to real GDP growth amounted to -3.3 percentage points, overall effect of net exports appeared to be negative for the first time since 2013.

Non-oil exports and imports

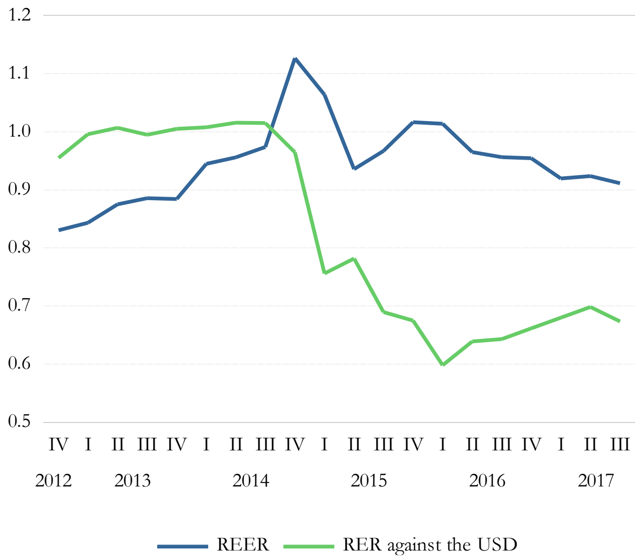
Non-oil exports recovery was driven by recovery in Russia (Figure 4) and by further depreciation of real effective exchange rate (Figure 6). Both growth sources seem to be not very reliable in a longer term. On the one hand, Russian recovery is not steady: in the 2017Q3, economic growth rate fell, and most likely it will stay low in the nearest future. On the other hand, real depreciation of Belarusian rouble that supported price competitiveness of our exports was driven by fast disinflation in Belarus (see **Ошибка! Источник ссылки не найден.**a) and appreciation of the Russian rouble (see **Ошибка! Источник ссылки не найден.**b). Further disinflation is not expected by the NBB, while further appreciation of the Russian rouble is possible only in case of sizable oil price increase. Thus, in the nearest future, non-oil exports dynamics will be determined mainly by non-price competitiveness of Belarusian producers.

Figure 4. Real GDP growth rates in Belarus, Russia, and Euro Area, % yoy



Source: Belstat for Belarus, Eurostat for Euro Area (19 countries), Rosstat for Russia; 2017Q3 – open sources (Russia).

Figure 5. Real exchange rates, indexes, 2014 = 1

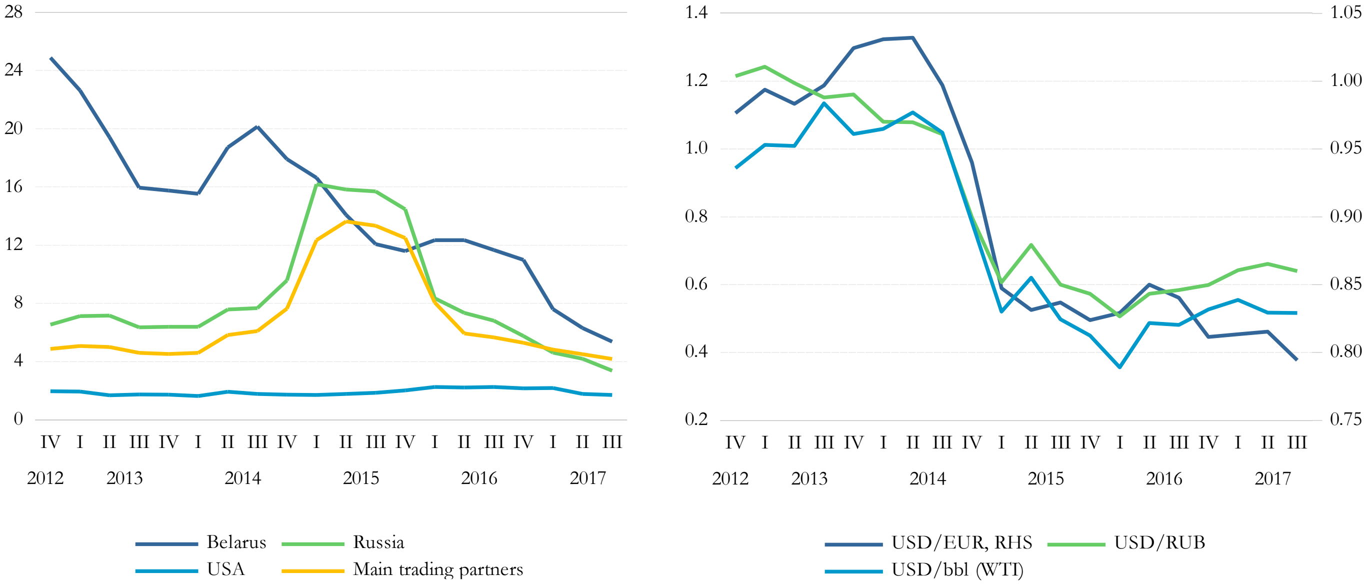


Source: IPM Research Centre.

[4] Many methodological issues arise around several sources of fixed capital investment financing: accounting of Russian loans for nuclear power plant construction (sometimes as budget, sometimes as foreign banks' loans), and own resources of enterprises (sometimes it is more correct to account them as budget-financed investment, taking into account the fact that most of them are related to SOEs).

[5] Non-oil exports (imports) are calculated as total exports (imports) or goods and services minus exports (imports) of the respective merchandise groups from the Table 2 (Annex).

Figure 6. Prices and key exchange rates



(a) Price indexes, % yoy **(b) Exchange rates and crude oil price (indexes, 2014=1)**

Note. Main trading partners are weighted by the REER weights.
Source: IFS database (CPI in main trading partners and exchange rates); Belstat (Belarusian CPI); IFS/Index Mundi (WTI prices).

Factors that move non-oil imports changed in 2017Q3. In the second half of 2016 and the first half of 2017, non-oil imports growth was driven by non-energy intermediate imports needed to increase production on exports. In 2017Q3, contribution of consumer imports to total merchandise imports growth has become almost equal to those or non-energy intermediary imports, while contribution of investment imports even exceeded it. In other words, until 2017Q3, non-oil imports growth was driven by non-oil exports, while since 2017Q3 went up mainly because of domestic demand increase. Thus, domestic demand growth may turn to too fast expansion of non-oil imports, which will harm macroeconomic stability if not supported by adequate non-oil exports growth.

Oil exports and imports

Starting from 2017Q2 (when the gas conflict between Belarus and Russia was resolved), import of crude oil from Russia has been restoring, although it is still significantly below the announced level[6]. However, in 2017Q3, the volume of crude oil imports increased against the 2016Q3 (low-base effect) by 26.3% yoy, and so did the volume of oil products exports (by 41.3% yoy, see Annex, Table 2). Significant gap between the two growth rates is due to extraordinary fast growth of oil products import (Annex, Table 2). Belarus preferred to sell its refined oil products abroad and import them for own consumption in Russia (collecting export custom duties). As a result, during Jan-Sep 2017, Belarus imported 2.3 mln t of oil products that allowed it to keep 'consolidated' oil products exports[7] above 74% of crude oil imports. However, its structure changed comparing to Jan-Sep 2016: the share of bituminous mixtures increased from 1.8 to 10.5% of this 'consolidated' oil exports, i.e. the share of oil products that do not subject to export duties increased by the order of magnitude, although it is still lower than the share of solvents and lubricating preparations on peak of so called 'solvents schemes'.

After the five quarters of growth (and three quarters of very fast growth), volume of exports of potash fertilizers in 2017Q3 fell by 12% yoy, which was expected and caused by technical factors and high-base effect. As a result, contribution of potash fertilizers export to real GDP growth fell to -0.5 percentage points in 2017Q3 from +0.9 percentage points in 2017Q2 and even 1.5 and 1.6 percentage points in 2016Q4 and 2017Q1, respectively. Taking into account the fact that at the moment Belaruskali operates at almost full capacity, further growth of potash exports' contribution to economic growth can hardly be significant at least until 2021, when the exploration of the new potash deposit is planned to be launched by Slavkaliy.

Summary

Belarus is facing economic recovery, which is based on the achieved macroeconomic stability, exchange rate regime, and some restoration of capital expenditures of local budgets (on the policies side), and is driven by broad-based non-oil export growth (although decelerating), recovery of crude oil supply from Russia, and more positive consumer expectations (caused by the recovery itself and better labor market stance). Although this list of factors is long, it is too early to claim this recovery sustainable. Domestic demand increase causes faster growth of non-oil imports, and too eager attempts to boost it above the fundamentally acceptable level may soon lead to a new balance of payments crisis. Thus, macroeconomic stability ensured via independence of the National Bank should stay an unconditional priority despite the fact that even short-term growth potential is limited by a very slow pace of recovery in Russia, low attractiveness of Belarus for foreign investment, and unacceptably low diversification of Belarusian exports[8].

[6] Belarus got 5 and 4.5 mln t in 2017Q2 and Q3, respectively, comparing to average 6 mln t per quarter that follow from the statement of the Russian Deputy Prime-Minister.
[7] Here 'consolidated' oil exports include oil products (2710) and bituminous mixtures (2715) exports.
[8] See Tochitskaya, I. (2017). "Indicators of Belarus export activity in the 1998-2016: what are the chances for growth?", *working paper* WP/17/02, IPM Research Center.

Annex

Table 1. Real GDP and aggregate demand

	2012	2013	2014	2015	2016	2016Q4	2017Q1	2017Q2	2017Q3
Growth rates, % yoy									
Real GDP	**1.6**	**1.0**	**1.7**	**-3.8**	**-2.6**	**-1.9**	**0.4**	**1.7**	**2.8**
Domestic Demand	*2.0*	*8.0*	*-0.2*	*-7.6*	*-6.1*	*-6.1*	*-1.6*	*1.2*	*4.6*
Household consumption	10.9	10.8	4.3	-2.4	-3.9	-6.0	-0.4	2.7	5.5
Gross fixed capital formation	-11.5	9.0	-5.8	-15.5	-16.7	-10.9	-4.4	-0.3	8.4
Other domestic demand components	11.1	-1.5	-1.6	-8.2	6.7	4.4	-2.1	-2.0	-2.8
Exports of goods and services ('non-oil')	7.8	-3.0	-0.5	-7.0	16.4	29.9	25.8	10.5	5.0
Imports of goods and services ('non-oil')	9.6	13.5	0.1	-12.7	2.0	8.1	10.1	8.3	9.2
Exports of goods ('oil')	15.2	-33.4	17.6	11.1	-17.5	-33.4	-24.5	0.2	23.9
Imports of goods ('oil')	16.3	-35.1	5.5	6.7	-13.1	-27.4	-10.6	3.5	30.2
Contribution to real GDP growth, percentage points									
Domestic Demand	*2.0*	*7.7*	*-0.2*	*-7.7*	*-5.9*	*-6.2*	*-1.5*	*1.1*	*4.3*
Household consumption	4.6	5.0	2.2	-1.2	-2.1	-3.0	-0.2	1.4	2.9
Gross fixed capital formation	-4.4	3.0	-2.1	-5.1	-4.9	-3.8	-0.9	-0.1	1.9
Other domestic demand components	1.7	-0.3	-0.3	-1.3	1.0	0.6	-0.4	-0.3	-0.5
Net exports of goods and services + statistical discrepancy	*-0.3*	*-6.8*	*1.8*	*3.8*	*3.3*	*4.3*	*2.0*	*0.6*	*-1.5*
Exports of goods and services ('non-oil')	2.8	-1.2	-0.2	-2.5	5.7	9.2	9.8	4.7	2.2
Imports of goods and services ('non-oil')	-3.3	-5.1	0.0	5.3	-0.7	-2.8	-3.8	-3.6	-3.7
Exports of goods ('oil')	3.3	-8.1	2.8	2.1	-3.8	-6.9	-6.0	0.0	3.4
Imports of goods ('oil')	-3.1	7.6	-0.8	-1.0	2.1	4.8	2.0	-0.5	-3.3

Source: actual figures – Belstat/own calculations based on Belstat data; 2017Q3 – estimates by the IPM Research Centre.

Table 2. Prices and volumes of 'oil' exports and imports

		2016Q4	2017Q1	2017Q2	2017Q3
Exports					
Crude oil (2709)					
volume	Kt	404.1	402.3	405.2	406.4
	% yoy	-0.5	0.0	-0.8	1.2
price	USD/t	335.2	365.5	341.9	360.6
	% yoy	15.8	66.7	12.2	17.3
Oil products (2710)					
volume	Kt	2032.7	2565.4	3556.3	2990.4
	% yoy	-52.0	-45.7	-14.1	41.3
price	USD/t	383.8	433.7	430.5	416.8
	% yoy	6.0	72.8	39.2	10.4
Bituminous mixtures (2715)					
volume	Kt	174.5	407.2	344.0	313.4
	% yoy	52.6	50800.0	1422.1	75.2
price	USD/t	257.5	284.2	258.1	260.2
	% yoy	70.8	-22.8	36.8	37.9
Total, oil and oil products	**USD mln**	**960.6**	**1375.3**	**1758.2**	**1474.6**
Potash fertilizers (3104)					
volume	Kt	1662.3	1581.1	1679.0	1524.4
	% yoy	61.5	58.8	27.6	-12.0
price	USD/t	330.7	336.1	349.6	363.3
	% yoy	-28.6	-18.5	-3.7	7.5
Total, oil + potash	**USD mln**	**1510.3**	**1906.7**	**2345.2**	**2028.4**

		2016Q4	2017Q1	2017Q2	2017Q3
Imports					
Crude oil (2709)					
volume	Kt	3063.0	4055.3	5031.7	4512.1
	% yoy	-47.5	-29.8	-12.5	26.3
price	USD/t	249.0	288.4	263.9	286.1
	% yoy	21.2	67.6	7.9	26.3
Oil products (2710)					
volume	Kt	562.6	706.7	733.9	876.4
	% yoy	-12.9	113.3	104.7	87.9
price	USD/t	334.6	322.4	322.7	332.4
	% yoy	22.5	16.4	-13.9	2.5
Natural gas (2711)					
volume	Kt	5949.0	5600.3	4049.0	3768.1
	% yoy	7.4	-0.7	14.1	7.6
price	USD/t	136.2	144.7	145.4	147.5
	% yoy	-6.7	6.1	5.7	7.7
Total	**USD mln**	**1761.0**	**2207.8**	**2153.5**	**2138.0**

Note. K (kilo-) stands for thousand. 'Oil' exports as defined in the text and Table 1 also include other oil-related goods that differ by year (solvents, antioxidants, etc.).
Source: Belstat.