BELARUSIAN MACROECONOMIC FORECAST

No. 1(4), May 2012

Striking the right balance between growth and macroeconomic stability

Executive summary

GDP: Due to a positive export shock, the crucial adjustment of imports from non-CIS countries, and more active wage stimulation, we expect that the recovery in 2012 will be more rapid than previously expected. Our expectation of real GDP growth in 2012 is 4.9%, which will be driven by improvements in net exports and a relatively high growth rate of household consumption. However, the year 2012 is more likely to be an outlier in terms of economic growth, rather than the beginning of a period of sustainably high growth. Under current assumptions, we forecast for 2013 a moderation of growth to 4.1% yoy, more in line with potential growth, which will result in the lack of funds for investment financing as the priority challenge, lack of competitiveness at foreign markets, and related issues.

Monetary environment: Financial stability is still considered to be an issue of concern, while high and volatile inflation expectations are an obstacle for a stable demand for national currency. Through this, the results of nominal indicators are extremely dependent on the policies of the monetary authorities. Based on the assumption of a rather conservative monetary policy stance, we expect annual average inflation of 61.4% in 2012 (which corresponds to roughly 25% of year-end inflation), while in 2013 22.6 (roughly 20% of year-end inflation). As for the exchange rate vs. US dollar, we expect USD/BYR 9000 and 9600 as of the end of 2012 and 2013, respectively.

Public finances: Fiscal policy is expected to remain tight, as there is still a high risk of inflation, taking into account high inflation expectations and low cost coverage by utilities tariffs. The consolidated budget is expected to be run with a surplus of 0.2% of GDP in 2012. The key pressure on public finances is stemming from public debt servicing costs that imply a budget deficit in 2013.

Balance of payments: In 2012 the current account deficit will be around USD 3.1 bn, or 5.7% of GDP, and will shrink in comparison to the previous year due to growth of exports supported by increase in trade in petroleum products with non-CIS countries, and reduction in imports as consequence of the new terms of oil and gas supplies from Russia. In 2013 the deficit will expand to USD 3.2 bn or 5.1% of GDP. We forecast that due to the sale of state shares in enterprises FDI inflow will be around USD 3.4 bn in 2012 but will increase to USD 3.6 bn in 2013. We expect the capital and financial account balance will be in surplus at USD 7.2 bn in 2012 and at USD 5.7 bn in 2013.

Key forecast figures

	2009	2010	2011	2012F	2013F
Real GDP, % yoy	0.2	7.7	5.3	4.9	4.1
Consolidated budget balance, % of GDP*	-0.7	-2.6	2.3	0.2	-1.4
Current account balance, % of GDP**	-12.6	-15.0	-12.6	-5.7	-5.1
CPI, % yoy (aop)	13.0	7.7	52.3	61.4	22.6
Gross external debt, % of GDP**	45.1	52.5	74.2	70.6	66.0

* Since 2010 Social Security Fund is not included.
** For 2011 indicators are calculated based on the market exchange rate (on average – 5984 USD/BYR).
Sources: National Statistical Committee, NBB, Minfin, GET forecast for 2012 -2013.

Forecast calculations were completed in April 2012. Next revision is scheduled for November 2012.

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MACROECONOMY

In search of new sources of growth

The recovery in 2012 seems to be more rapid than it was expected in our previous forecast. More favourable conditions on energy trade seem to be a core reason for this. First, it resulted in additional exports in nominal terms, which determines more output of correspondent industries. Second, it contributed to the balance between supply and demand at the domestic currency market, thus improving the expectations of the agents somehow and promoting their economic activity. Third, the initial impulse of incomes growth due to oil trade transmitted to the domestic market pushing household consumption along with capital investment up from their cyclical troughs.

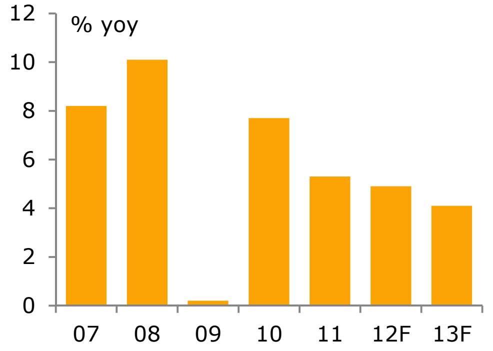
Wage dynamics was another factor responsible for strengthened growth. Having faced a substantial labour force outflow on the back of the sensitive real wage adjustments during the previous year (which may become a significant long-term negative factor), the government did all its best in order to recover its level in real terms more promptly. Given accumulated consolidated surplus in 2011 due to conservative spending policy, rather tough monetary policy that allowed enhancing more stability at the money market, the authorities got a chance to resort to more active hikes of wages. Thus, since the beginning of the year, economic authorities began raising wages more rapidly than it was expected.

Through this we expect in 2012 a relative strong output growth of 4.9%. From the demand side it is going to be driven by household consumption and net exports: 3.6 and 1.4 percentage points of contributions to growth. Improvements in net exports mostly arise from the enormous adjustment of the imports from non-CIS countries. According to our projections, it will reduce by 15.1% in real terms on an annual basis.

One more major domestic demand component – capital investments – seems to stay fragile. This is mainly the consequence of adjustments of state programs, a reshaping of the directed lending system, and tight monetary policy of the National Bank, a policy mix that is still inevitable in order to maintain macroeconomic stability. At the same time, the lack of funds for capital investments might undermine future perspectives of economic growth.

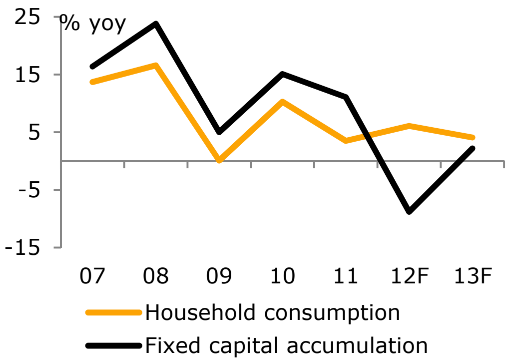
From a medium-term perspective, a core question is whether new terms and conditions of energy trade is (i) a positive short-term shock, which will nudge the recovery, (ii) single-step shock (level shift) of potential GDP, or (iii) a permanent long-term shock of the growth rate of potential GDP. Our current projections support more the 1st and 2nd option, which means that the tendency of growth strengthening in 2012 might not be sustainable. Accordingly, our forecast for 2013 forms a picture when improvements in net exports are over, because the devaluation and favourable energy trade effects will be exhausted by that time (in terms of stimulating the growth rate), while main domestic demand components are still fragile suffering a lack of sustainable growth mechanisms. Under these conditions, we forecast 4.1% yoy GDP growth in 2013. This scenario assumes that the near future might become a period of sporadic search for new growth drivers, since the previous ones lost their steam.

Real GDP growth



Source: National Statistical Committee, GET forecasts 2012–2013.

Household consumption and fixed capital accumulation



Source: National Statistical Committee, GET forecasts 2012–2013.

Contributions to GDP Growth

	2011	2012F	2013F
GDP	**5.3**	**4.9**	**4.1**
Household consumption	2.1	3.6	2.5
Gross fixed capital formation	4.7	-4.0	0.9
Net exports	3.7	1.4	-2.2
Other components+ statistical discrepancy	-5.2	3.8	3.0

Note. Contribution to growth – in percentage points of GDP.
Source: 2011 - National Statistical Committee, GET forecasts 2012–2013.

MONETARY ENVIRONMENT

Financial issues are still a concern

Rather tight monetary policy carried out by the National Bank since December 2011 led to positive trends at the money and capital markets. The problems of weakening demand for the

Belarusian ruble and increasing dollarization (in form of both financial dollarization and currency substitution) have been mainly solved as of now. However, there is still a problem within the monetary sphere: inflation expectations are still high and volatile. Their high level restricts the room for monetary policy, making it less effective (in the sense that the National Bank has low possibilities to transmit lower rates to the economy without hurting the stability at the money market and domestic currency market). Their increased volatility might be an even worse signal than their high level. It might mean that the trust of economic agents to any potential nominal anchor in the economy is low (especially given a situation when there is currently de-facto no nominal anchor) and change their behavior dramatically given any positive or adverse shock. This means that the money market and through it the whole economy might be sensitive to any kind of shocks. For monetary policy it results again in the lack of effectiveness, while the predictability of the behavior of the agents is low. From the view of economic forecasts, it means that their conditionality on the assumptions considered increases.

Realising the challenges in the monetary sphere, we expect the National Bank to adhere to a reasonable tight policy, trying to anchor and lower the expectations through enhancing stability at the money market. Furthermore, we expect that directed lending will be kept suppressed during coming periods. There might be a trend back towards more active usage of both conventional and unconventional monetary policy tools because of the lack of the growth. However, we still expect these adjustments in policies to be rather mild, otherwise the problems associated with unstable and volatile expectations may arise at any moment.

Under our assumptions, the banking sector will gradually increase credit supply, but it still will be rather modest (again due to inflation expectations and low activity in directed lending). Gradually, when the real interest rates on national currency loans will come down from their prohibitive levels, we also expect some more adjustments in the exchange rate. That is because currently it is affected notably by households and legal entities, who vary the shares of different currencies in their portfolio given high interest rates in national currency. These trends will lead to some disinflation due to monetary factors. However, the consumer price index will be under pressure by administratively regulated prices, the adjustment of which was postponed by the government from past periods to future ones.

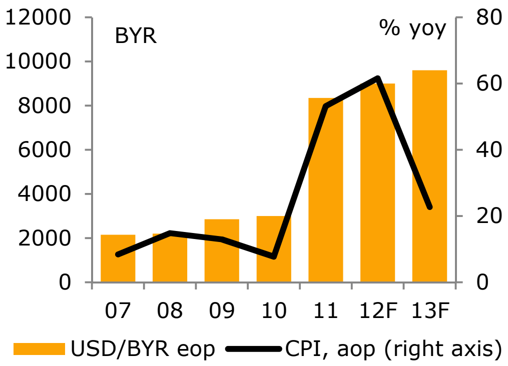
In this environment, we expect a gradual depreciation of the Belarusian ruble during the period. With respect to the US dollar our projections result in exchange rate USD/BYR 9000 by the end of 2012 (with roughly USD/BYR 8500 of annual average). For 2013, the correspondent figures are: USD/BYR 9600 and 9300 (annual average). As for inflation, we expect average annual CPI inflation of 61.4% in 2012 and 22.7% in 2013. These dynamics will determine a gradual real appreciation of the national currency in the projected period, which however is going to comply with a relatively balanced current account.

PUBLIC FINANCES

Tight fiscal policy will continue

The forecast for public finances in 2012–2013 is based on the assumption that the government will run a tight fiscal policy. There are question marks for this policy stance, which are rooted in the desire to accelerate growth up to the level set in the

Exchange rate and prices



Source: NBB, GET forecasts 2012–2013.

five-year plan. However, we believe that incentives for an expansionary policy in the short-run will be weak enough due to the crisis experienced in 2011. In such an environment, the consolidated budget balance is expected to be slightly positive in 2012 (0.2% of GDP) and moderately negative in 2013 (-1.4% of GDP), as there will be growing pressure on public accounts from debt servicing obligations and recovering capital expenditures.

Consolidated budget expenditures are estimated to be equal to 27.6% of GDP in 2012, which is 1.4 percentage points less than in 2011. Besides, a serious reshaping of expenditures structure is assumed. On the one hand, there will be inevitable growth of public expenditures on public debt servicing by 0.2% of GDP in 2012. Another growing expenditure line is current transfers and subsidies (by 0.2% of GDP), fueled by a deteriorated welfare of the population and need for broader social support. On the other hand, we expect cuts in capital expenditures by 0.6 percentage points on the back of high base effect of the first part of 2011, as fiscal policy tightening reached its momentum only in the second half of 2011. Furthermore, the need for tight fiscal policy will force reduction of public purchases.

Consolidated budget revenues are forecast to fall by 3.4 percentage points down to 27.8% of GDP. However most of the reduction (1.6 percentage points) will happen at the expenses of non-tax revenues, as interest and royalty revenue, as well as profit of public sector organisations is falling due to the crisis. Within tax income, most of reduction is expected in connection to foreign trade. First of all, reduction of personal auto imports affects import duties revenue. Second, overall import contraction with respect to GDP will result in further duties and VAT reduction. These effects are estimated to cut public revenues by 0.2% and 1.4% of GDP via shrinking VAT and import duties revenues, respectively. Another 0.2% of GDP reduction is assigned to profit tax revenues, as there has been a tax rate reduction in 2012.

BALANCE OF PAYMENTS

Current account: Further Improvement

In 2011 the deficit of trade in goods and services narrowed considerably and constituted 3% of GDP in comparison to 13.5% of GDP in 2010. The current account deficit shrank by 30.2% to USD 5.8 bn (12.6% of GDP). We expect that the balance of trade in goods and services in 2012 will be positive and reach USD 1.4 bn (2.6 % GDP) helping to shrink the negative current account balance to USD 3.1 bn in 2012 (5.7% of GDP). In 2013, however, it will slightly expand to USD 3.2 bn, (5.1% of GDP).

During 2011 merchandise exports grew faster than imports (59.4% yoy and 31.1% in dollar terms, respectively) due to an increase in energy goods exports. For 2012 we expect further rise in exports, and decrease in imports mainly owning to new agreements with Russia on terms of oil and gas supply. Export growth will be attributed to the growth of trade in petroleum products with non-CIS countries, and sales of Belarusians machines and equipment (including products of automotive industry), as well as food products to Russia. A decrease in imports will be triggered by a reduction of prices on oil supplied from Russia by USD 20-40 per ton, and on gas from average USD 265.5 per 1,000 cubic meters in 2011 to average USD 165.6 per 1,000 cubic meters, as well as a fall in consumer goods' imports due to reduction of domestic demand. We expect that in 2012 balance of merchandise trade will be negative and account for USD 0.7 bn. In 2013 balance of merchandise trade will be in negative as well but it will go down and is expected to be at around USD 0.5 bn.

Fiscal indicators, % of GDP

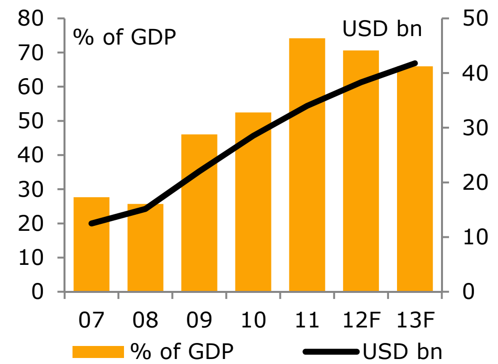
	2011	2012F	2013F
Consolidated revenues	31.2	27.8	26.9
Consolidated expenditures	29.0	27.6	28.3
Consolidated budget balance	2.3	0.2	-1.4

Source: Ministry of Finance, GET forecasts 2012–2013.

Merchandise trade

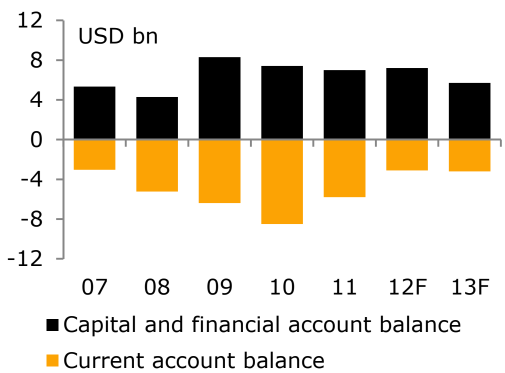
Source: National Statistical Committee, GET forecasts 2012–2013.

Gross external debt



Source: NBB, GET forecasts 2012–2013.

Balance of payments



Source: NBB, GET forecasts 2012–2013.

In 2012 and 2013, the balance of trade in services will be positive at around USD 2.2 bn and 2.2 bn, respectively. The export growth will come from increase in oil and gas transit and transportation services, while services imports growth will expand almost at the same pace and will be supported by expansion of transportation and travel services.

We expect that the current transfers balance will be negative in 2012 and 2013 as a consequence of the transfer of export duties on Belarusian oil refinery products to the Russian budget. The transfer of these duties will significantly exceed the inflow of customs duties accrued according to the agreement between Russian, Belarus and Kazakhstan on distribution of import customs duties within the Customs Union. According to the forecast, the negative income balance will further expand in 2012 and 2013 owing to a growing deficit of investment incomes stemming from an increase of amount of interest payable under general government (including interests payment on the IMF loan) and non-financial sector obligations (including payment on the loans of banking and non-financial sectors, and income payments on FDI.

Capital and financial account: Surplus will narrow in 2012-2013

We expect that in 2012 net FDI inflow will be USD 3.4 bn. The FDI inflow will be attributed to M&A deals in industry, banking and service sectors, including the sale of the state shares of mobile operator MTS. Net inflow of other investment is expected at USD 3.6 bn due to the attraction of loans (including a loan from the Anti-Crisis Fund of the EvrAzES USD 880 m).

In 2013, we expect that further sale of state-owned enterprise shares will result in a slight increase in FDI inflows (to USD 3.6 bn) in comparison with the previous year. We do not forecast the inflow of portfolio investments neither in 2012 nor in 2013. We expect that the capital and financial account surplus will decrease by 20.8% yoy in 2013 in comparison to 2012.

Annex. Tables

		2009	2010	2011	2012F	2013F
Table 1. GDP						
Nominal GDP	BYR bn	137 442	164 476	274 282	461 692	589 562
	USD bn**	49.2	55.2	45.9	54.3	63.4
Real GDP	% yoy	0.2	7.7	5.3	4.9	4.1
Household consumption	% yoy	0.1	10.3	3.5	6.1	4.2
Public consumption	% yoy	-0.1	0.9	1.0	-3.4	9.1
Fixed capital accumulation	% yoy	5.0	15.1	11.1	-8.8	2.2
Exports	% yoy	-11.3	2.8	29.5	-5.3	-1.7
Imports	% yoy	-11.7	8.2	16.8	-6.4	1.9
Table 2. Fiscal Indicators*						
Consolidated budget revenues	BYR bn	62 808	48 754	85 608	128 480	158 851
	% of GDP	45.7	29.6	31.2	27.8	26.9
EPT revenues	BYR bn	4 608	5 580	8 689	13 851	18 276
	% of GDP	3.4	3.4	3.2	3.0	3.1
VAT revenues	BYR bn	12 083	16 226	26 499	43 861	56 008
	% of GDP	8.8	9.9	9.7	9.5	9.5
PIT revenues	BYR bn	4 305	5 381	9 316	14 774	17 090
	% of GDP	3.1	3.3	3.4	3.2	2.9
Consolidated budget expenditures	BYR bn	63 766	52 980	79 428	127 609	167 127
	% of GDP	46.4	32.2	29.0	27.6	28.3
Current expenditures	% of GDP	34.6	24.0	23.3	22.7	22.9
Capital expenditures	% of GDP	8.1	8.3	5.5	4.9	5.4
Consolidated budget balance	% of GDP*	-0.7	-2.6	2.3	0.2	-1.4
Table 3. Balance of Payments and External Debt						
Current account balance	USD bn	-6.2	-8.3	-5.8	-3.1	-3.2
	% GDP**	-12.6	-15.0	-12.6	-5.7	-5.1
Export of goods	USD bn	21.4	25.3	41.4	41.0	42.7
Import of goods	USD bn	28.3	34.5	45.1	41.8	43.2
Balance of services	USD bn	1.4	1.7	2.1	2.2	2.2
Capital and financial account balance	USD bn	8.3	7.4	7.0	7.2	5.7
Foreign direct investments (FDI)	USD bn	1.8	1.3	3.9	3.4	3.6
Portfolio investments	USD bn	0.0	1.2	0.9	0.0	0.0
Gross external debt	% of GDP**	45.1	52.2	74.2	70.6	66.0
Table 4. Money, Inflation and Exchange Rate						
Base money	%, yoy eop	-11.5	49.5	84.1	19.0	34.8
CPI	%, yoy aop	13.0	7.7	52.3	61.4	22.6
Exchange rate, USD/BYR	Eop	2 859	3 000	8 350	9000	9 600

* Since 2010 Social Security Fund is not included.
** For 2011 this indicator is calculated based on the market exchange rate (for 2011 on average – 5984 USD/BYR).
Sources: National Statistical Committee, Ministry of Finance, NBB, GET forecasts 2012–2013.

Notes:

aop	average of period	NBB	National Bank of Belarus
avg	Average	p.a.	per annum
bn	Billion	PIT	personal income tax
eop	end of period	VAT	value added tax
EPT	enterprise profit tax	yoy	year-on-year
m	million	ytd	year-to-date

Annex. Assumptions of the forecast

- World prices for crude oil (oil basket) will be USD 100 per barrel on average in 2012 and USD 102 per barrel on average in 2013.
- Belarus will get 21.5 m t of crude oil from Russia both in 2012 and 2013 respectively on a duty-free basis. Moreover, in 2012 and 2013 1 m t of Venezuelan and Azerbaijan oil will be imported, which will correspondently contribute to exports of oil products.
- The prices of imported gas from Russia will be USD 166 per tcm (yearly average) in both 2012 and 2013.
- In both 2012 and 2013 the government will receive USD 2.5 bn of privatisation revenues, and USD 2.5 bn and 2.0 bn of new foreign borrowings associated with different sources.

About the German Economic Team Belarus (GET Belarus)

The main purpose of GET Belarus is to conduct a dialogue on economic policy issues with the government, civil society, and international organizations. Experts of German Economic Team have experience in policy advice in several transition economies, including Ukraine, Russia, and Moldova. In Belarus the IPM Research Center and the German Economic Team provide information and analytical support to the Council of Ministers, the National Bank, the Ministry of Foreign Affairs, the Ministry of Economy and other institutions involved in the process of formation and implementation of economic policy.

About the IPM Research Center

The IPM Research Center was established in 1999 within the mutual project of the Institute for Privatization and Management (Minsk, Belarus) and CASE - Center for Social and Economic Research Foundation (Warsaw, Poland). It is a member of the CASE research network, William Davidson Institute NGO Alliance, and Economic Policy Institutes Network (project of the UNDP's Regional Bureau for Europe and the CIS). The IPM Research Center actively cooperates with the German Economic Team Belarus (GET Belarus). Within this cooperation the IPM Research Center provides independent policy advice on economic issues to the different official agencies, namely to the Council of Ministers, National Bank, Ministry of Economy, Ministry of Finance and other organizations involved in the process of formation and implementation of economic policy.

The Mission of the IPM Research Center is to enhance national competitiveness through elaboration of the research-based economic policy recommendation and the promotion of professional dialogue on the urgent issues related to economic performance.

Activities

- Regular analysis of the economy of Belarus;
- Monitoring of main sectors of the economy;
- Promotion of professional dialogue between Belarusian and German experts on important issues for the economic development of Belarus.

Analytical materials

Current research products and publications of the project are available via the Internet:

http://research.by/get and www.get-belarus.de

Belarusian Monthly Economic Review (BMER)
A monthly bulletin has been published since October 2002. It provides readers with recent news on politics and economics, covering such sectors of the economy as the real sector, structural trends, the external sector, public finance, monetary policy and the banking sector.

Policy Papers
Analytical materials on specific economic issues providing policy recommendations for the government and other organisations involved in the process of formulating and implementing economic policy.

Belarus Infrastructure Monitoring
Monitoring of the current situation and the perspectives for the development of the energy, telecommunications and transport sectors in Belarus. The following sectors are monitored in detail: electricity, gas, communication and communication services, railways and roads.