DIGITALES ARCHIV

ZBW – Leibniz-Informationszentrum Wirtschaft
ZBW – Leibniz Information Centre for Economics

Periodical Part

Economic outlook / Belaruski Ėkanamičny Dasledča-Adukacyjny Centr. 2020

Economic outlook / Belaruski Ėkanamičny Dasledča-Adukacyjny Centr

Provided in Cooperation with:
Belarusian Economic Research and Outreach Center (BEROC), Minsk

Reference: In: Economic outlook / Belaruski Ėkanamičny Dasledča-Adukacyjny Centr Economic outlook / Belaruski Ėkanamičny Dasledča-Adukacyjny Centr. 2020 (2020). https://beroc.org/upload/iblock/bab/bab6ab70d58dd294e763134628e36cd8.pdf. https://beroc.org/upload/iblock/090/0905f36e9689c76a13e9078f62e8f0d1.pdf.

This Version is available at:
http://hdl.handle.net/11159/703101

Kontakt/Contact
ZBW – Leibniz-Informationszentrum Wirtschaft/Leibniz Information Centre for Economics
Düsternbrooker Weg 120
24105 Kiel (Germany)
E-Mail: *rights[at]zbw.eu*
https://www.zbw.eu/econis-archiv/

Standard-Nutzungsbedingungen:
Dieses Dokument darf zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden. Sie dürfen dieses Dokument nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, aufführen, vertreiben oder anderweitig nutzen. Sofern für das Dokument eine Open-Content-Lizenz verwendet wurde, so gelten abweichend von diesen Nutzungsbedingungen die in der Lizenz gewährten Nutzungsrechte.

https://zbw.eu/econis-archiv/termsofuse

Terms of use:
This document may be saved and copied for your personal and scholarly purposes. You are not to copy it for public or commercial purposes, to exhibit the document in public, to perform, distribute or otherwise use the document in public. If the document is made available under a Creative Commons Licence you may exercise further usage rights as specified in the licence.

ZBW Leibniz-Informationszentrum Wirtschaft
Leibniz Information Centre for Economics

Mitglied der Leibniz-Gemeinschaft

BEROC Economic
Research Center

BEROC

Economic Outlook

First and Second Quarters 2020

Economic Outlook

First and Second Quarters 2020

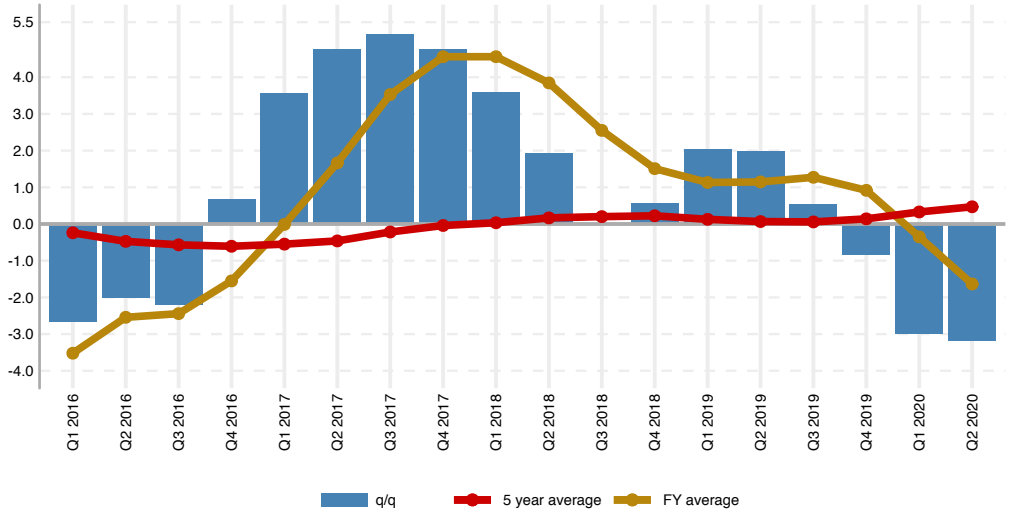
BEROC Economic Research Center

BEROC

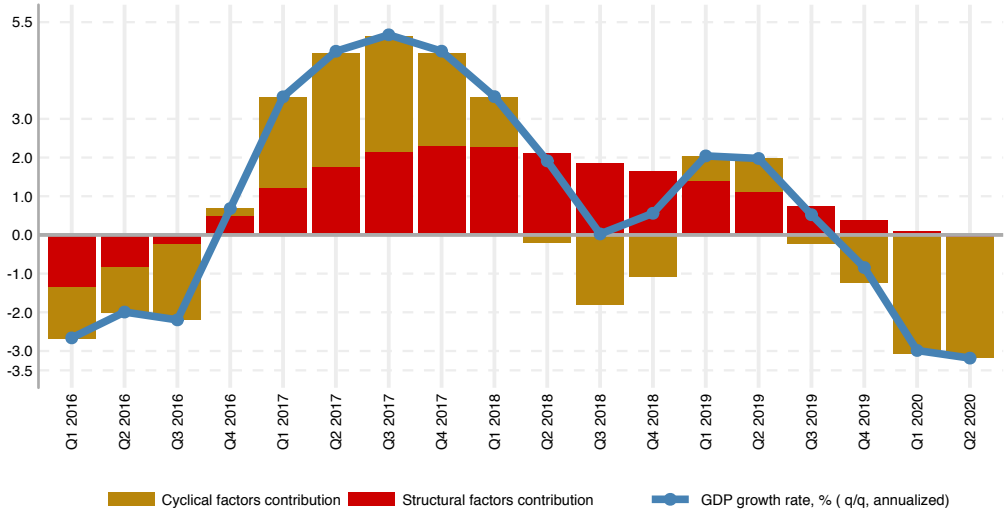
Coronacrisis: recession and future uncertainty

- Is curbing consumption a new trend?
- The monetary policy is easing
- The external demand has weakened, but the external equilibrium has been maintained
- The corporate debt burden has spiked, the debt quality has deteriorated
- A fiscal deficit is emerging
- Real wages are growing, but the labor market is choppy

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).

Current trends

Downturn in output and risks of a protracted recession

The impact of coronavirus became a key factor of the macroeconomic performance in the first six months of 2020. Against the backdrop of a fragile economic environment in Q1, the oil supply-related problem resulted in the output shifting to a cyclical downturn phase. But in view of the relatively rapid exhaustion of the shock, the prospects of growth resumption remained open. However, the coronavirus pandemic and its impact on the economy fundamentally changed the economic landscape. The downturn in output was sustained.

Meanwhile, in the first half of the year, and in Q2 in particular, the downturn was significantly smaller than it could have been expected based on the scale of the demand contraction. In Q2, the demand, including both external and domestic, dropped by about 20%. Other things being equal, this should have caused a fall in GDP close to 10% in Q2 and about 5% in the first six months. The de facto decline amounted to about 3% in Q2 and 1.7% in the first six months.

Such seemingly benign dynamics were driven by several factors. First, despite the sharp downfall of demand, output was maintained at the planned level at most large state-owned enterprises or decreased much more modestly compared to demand. As a result, such enterprises faced a rapid inventory build-up and declining liquidity ratios. In Q2, for the first time since the recession of 2015, inventories in industry reached the level of about 80% of the average monthly output. Second, the artificially sustained production at state-owned enterprises mitigated negative multiplication effects for the economy as a whole. For instance, state-owned enterprises maintained their demand for products of their counterparts. The consumer demand was also supported indirectly—by means of protecting the level of employment and wages in the state-owned enterprise sector. Third, the GDP was positively affected by some growing industries (agriculture, information and communications, construction), which demonstrated specific trends outweighing the negative impact of the coronacrisis.

Although the response to the coronacrisis based on maintaining the output in the state-owned enterprise sector generated a substantial effect in Q2, its expediency and efficiency are highly questionable. First, it significantly worsens the financial position of the enterprises involved in it, generating financial risks, which become significant on the scale of the entire economy. Second, enterprises will have to narrow the gap between their output and demand in subsequent periods by limiting their production and selling off their inventories. In other words, there is a high probability of a delayed and protracted recession: a deep, but less prolonged recession would be replaced with a not so deep, but more lasting downturn. In the absence of new internal and external shocks—which are highly probable, at least in the financial sector—this scenario would result in negative growth of 3.0-3.5% in 2020, followed by a weak growth recovery.

Institutional environment

Deteriorating long-term growth environment and challenges to financial stability

The coronacrisis has negatively affected not only the current environment, but, more likely, the prospects of long-term growth for the world economy. Even if the pandemic is overcome quickly enough, its impact will persist for at least 1-2 years. In the very least, that could be a result of global structural changes in the services sector, energy sector, and foreign trade chains, as well as delayed effects of unprecedented stimulus measures. Moreover, it remains unclear how long the pandemic will last and whether new restrictive measures and incentive packages will be needed. Worst-case scenarios for these unknown variables imply an even greater long-term negative impact on growth.

For Belarus, the deterioration of growth prospects is as relevant as for any other country. But on top of that, the coronacrisis may worsen the growth environment and amplify the challenges to the financial stability for a number of specific reasons.

First, a number of risks are related to the low energy prices established in the world market probably for a long time. The list of such risks includes, inter alia, the price competitiveness of local producers declining due to the fact that the gas price is fixed in absolute terms— against the background of the declining world prices, the price for Belarus is increasing in relative terms. Low oil prices reduce the benefits related to the specific terms of trade in oil and petroleum products. Finally, the most important risk is related to persistently weak external demand from Russia combined with low energy prices.

Second, the volatility of exchange rates in emerging economies is growing in the context of the coronacrisis. In the event of a new global financial shock, another phase of currency depreciation is highly likely in these countries, in particular in Russia. This would inevitably entail depreciation of the Belarusian rubel. And that shock may turn into a systemic risk to Belarus' financial stability in view of the high levels of its foreign currency-denominated debt burden and dollarization of the financial sector.

Third, the risks to Belarus' long-term growth and financial stability are aggravated by the country's specific response to the coronacrisis. The authorities maintain production at state-owned enterprises, thus undermining their financial position. It is to be partially off-set by the significantly intensified measures of "financial engineering", including restructuring of debts of state-owned enterprises, directed lending, non- conventional pressure on banks, etc. But it ultimately affects the financial stability of the whole economy, making it increasingly fragile and expanding its vulnerabilities. At present, those include the size of the debt burden and the quality of corporate debts, the quality of bank assets, the stability of banks' liabilities, the foreign exchange liquidity of the financial sector, as well as the sustainability of the public debt.

Background information

Signs of new “gas” battles?

In early 2020, the Belarusian authorities declared their position, stressing the need to reduce the price for gas imported from Russia. That was justified by the decrease in world prices, as well as a number of provisions in the Treaty on the EAEU. However, against the background of the oil conflict in February, the price approved as the “basic” one for 2020 was identical to that for 2019 – USD 127 per 3 1,000 m^3.

Unlike in 2017-2019, the price is not “compensated” through oil “re- clearance” arrangements, which generated revenues for the Belarusian budget of USD 0.5-1 billion per year—in 2020, the budget would have received about USD 0.4 billion. Moreover, the world gas prices continued to decline in Q2. For Belarusian enterprises, this results in a higher relative price and lower price competitiveness. Therefore, the Belarusian authorities became more assertive in defending their position to get the price reduced. Against this background, disputes began to arise between the parties about the state of settlements for gas supplies. Gazprom claims that there are arrears—according to different sources, ranging from USD 165 to 250 million—whereas the Belarusian side states that there are only differences of technical nature.

An additional source of collisions within the “gas agenda” may be the situation with Belgazprombank. In June, provisional administration was introduced in that bank, whose major owner is Gazprom. The rationale for that was related to accusations of the bank’s management of tax evasion and money laundering. In addition, the Belarusian authorities announced that Gazprom’s management had interfered in national political developments in Belarus.

Intensification of non-conventional interventions in the financial market

Non-conventional measures of financial support of state-owned enterprises significantly intensified in the first six months of the year, and especially in Q2. The main tool was to restructure old debts and reduce the cost of servicing them. At the same time, debt restructuring arrangements included a change of the creditor or debt for equity swaps. This reduces the transparency of credit relations, enabling statistical veiling of the scale of the debt burden.

The practice of new directed loans also intensified, contrary to the previously declared intention to phase it out by end-2020. The initially planned ceiling for directed lending in 2020 of BYN 740 million was raised by BYN 520 million, reaching BYN 1,260 million.

Finally, the most unconventional measure was probably the suspension of the National Bank’s facility of taking deposits from banks—as a tool to absorb excess liquidity. That step was aimed at pushing the banks, which had had excess liquidity for several years (due to a shortage of quality borrowers), to lend more actively to the real sector.

The large-scale intensification of financial support, which, in most cases, targets systemically weak state-owned enterprises, tangibly enhances risks to the financial stability.

Output and demand

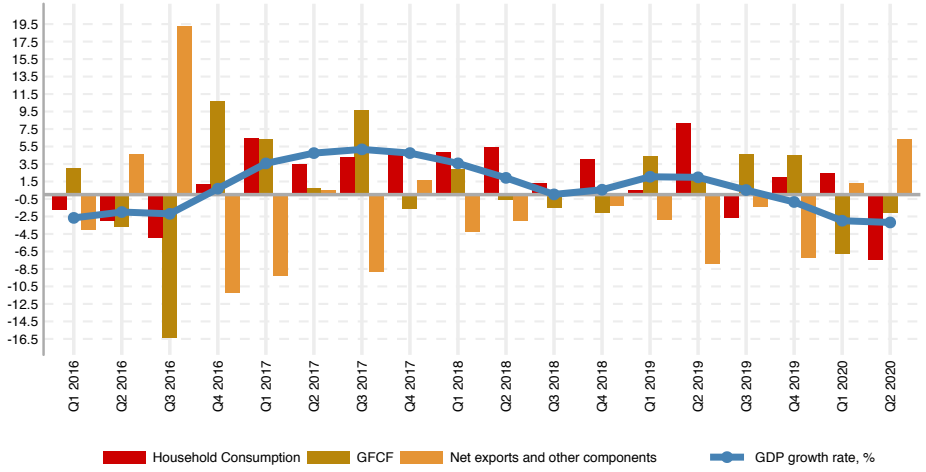
Is curbing consumption a new trend?

In the last three years, the key factor driving the GDP growth on the demand side was the household final consumption. In that period, the generated output growth was practically mirrored by the final consumption. Against the background of the output downfall shock in Q2, that demand component—which had demonstrated the greatest increase in previous periods—was also the most sensitive to changes in the environment. Therefore, despite the counter incentives put in place, it made the largest negative contribution to the output performance. In Q2, the role of such a "lightning rod" incentive within the demand structure was played by the accumulation of inventories.

However, if the coronacrisis happens to be protracted, the downward trend of the final consumption is likely to become persistent. In order to prevent/mitigate this scenario, the authorities would need to proactively implement stimulus measures. The problem is that most of them pose new risks. For example, active build-up of inventories represents a direct risk to the financial stability.

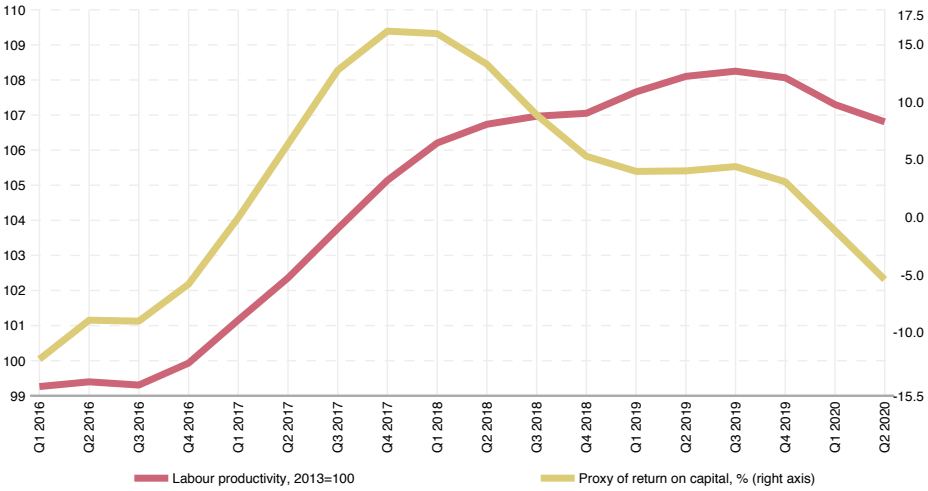
At the macroeconomic level, the coronacrisis and the ambiguous measures to counteract it led to poorer qualitative macroeconomic indicators. There was a significant decrease—for the first time since 2015—in the labor productivity. That indicates that firms were lacking sufficient opportunities to adjust their employment and wages in line with the changed conditions. In other words, firms were the ones bearing the brunt of the coronacrisis.

Contribution to output growth, percentage points



Note: The rate of the GDP growth and the relevant contribution of demand components are annualized quarter on quarter (with a seasonal adjustment); GFCF is gross fixed capital formation.

Quality growth indicators



Note: The proxy for the return on capital is calculated as a ratio of the annual average output growth to the share of GFCF in GDP.

Monetary sector

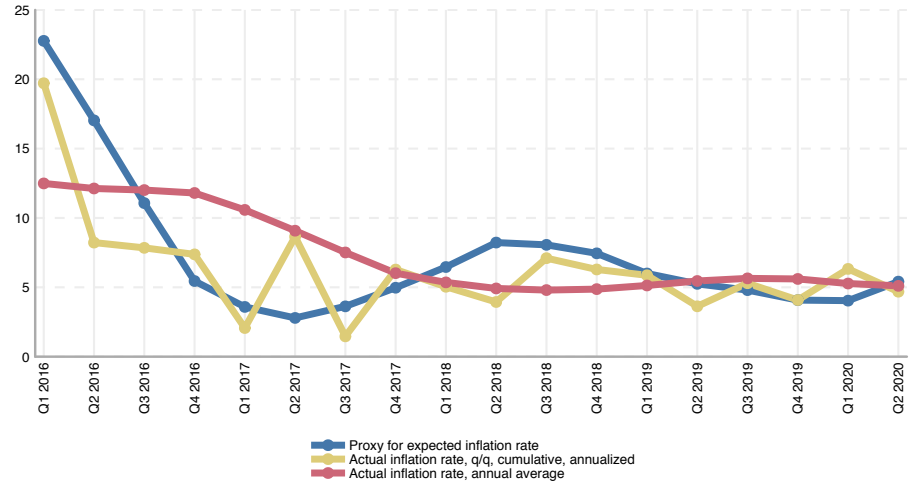
The inflation spike was subdued, but inflation expectations rose

There was an inflation spike in Q1. The driver of that was the BYN depreciation, which followed the RUB depreciation caused by a drop in world oil prices. In addition to a direct effect on prices, it also triggered inflation expectations and a number of adverse trends in the currency and deposit markets. In Q2, these pro-inflation factors began to abate (due to some exchange rate appreciation). In parallel, the disinflation factors associated with a downfall of demand against the background of the coronavirus pandemic started to gain strength. This contributed to a slowdown in actual inflation in Q2. However, the future dynamics of inflation in the context of such a conflict between the pro- and disinflation factors are not so unambiguous and would largely depend on the monetary policy stance.

The monetary policy is easing

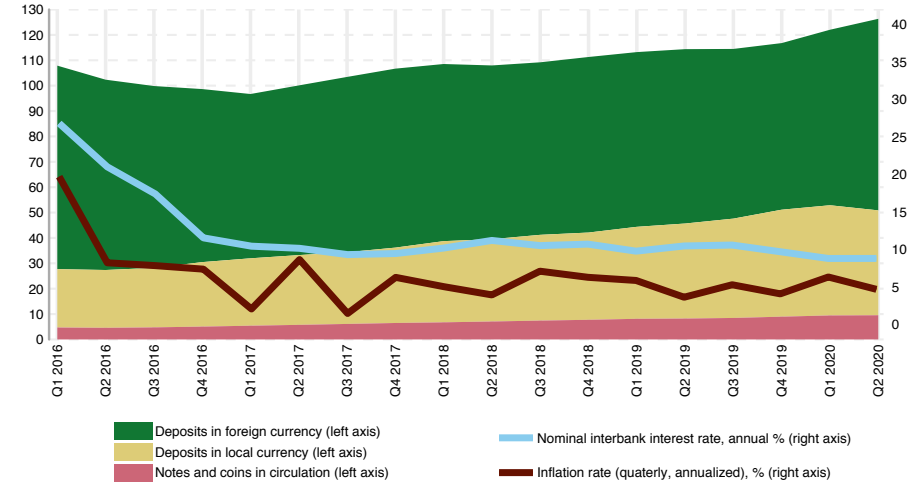
The strengthening disinflation factors helped the National Bank reduce the refinancing rate rather decisively to 8% per annum in May (by 0.75 p.p.). That translated into policy easing. However, its stance remained close to neutral, which is important against the background of persisting inflation risks. The refinancing rate was subsequently reduced again (to 7.75%). That was probably an attempt to find a delicate balance between the economic logic and the significantly increased pressure on the National Bank due to its allegedly excessively tough monetary policy.

Inflation and inflation expectations %



Note: The inflation expectations are calculated on the basis of the methodology developed by Kruk (2016). All the indicators are annualized in percent. The quarterly inflation is seasonally adjusted.

Interbank interest rate and monetary aggregates



Note: M3 components correspond to the scale M3 2015=100. All the indicators are seasonally adjusted in real terms.

Financial stability

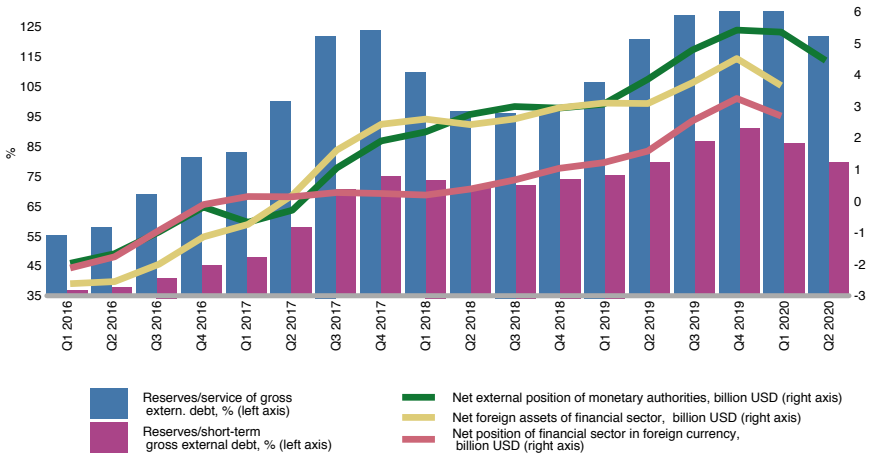
Foreign exchange liquidity ratios: the accumulated margin of safety has started to dwindle away

Increased demand for foreign exchange led to a deterioration of almost all the indicators that characterize the corresponding liquidity position. Thus, the relatively stable trend of their improvement observed in the last two years was reversed. So far, the risks to the financial stability associated with foreign exchange liquidity have been not so obvious and acute. First, there is a substantial margin of safety accumulated in previous years. Second, the authorities were able to smooth things out by mobilizing new borrowings.

The corporate debt burden has spiked, the debt quality has deteriorated

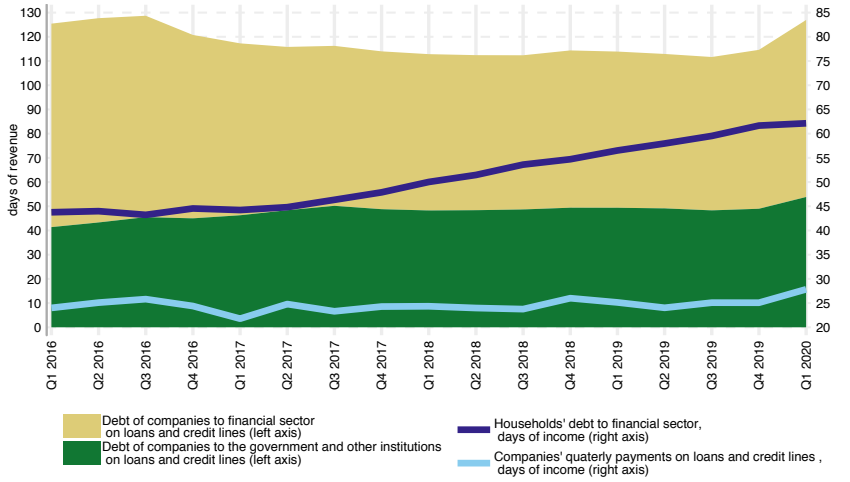
In the first six months of the year, banks were fairly conservative in providing new loans. Claims under foreign exchange loans remained virtually unchanged in their foreign currency equivalent, and those under BYN loans grew very moderately. That happened despite the persistence of excess liquidity in the banking system. Banks' behavior was associated with a tangible deterioration in the financial position of firms amid the coronacrisis and a shortage of quality borrowers acceptable for banks. Firms faced a significant rise of their debt burden due to a decline in their revenues, as well as an increase in the BYN equivalent of their foreign exchange loan liabilities. Therefore, the issues of the corporate debt sustainability became more acute for the economy as a whole.

Foreign exchange liquidity indicators



Note: The indicators of reserve assets are as of the beginning of the quarter. The gross external debt service includes interest and principal payments for the previous 12 months. The net external position of the monetary authorities is calculated as the difference between the reserve assets and the costs associated with them over the coming 12 months.

Size and quality of private debt



Note: Companies' liabilities to the government etc. under loans are calculated as the difference between the total amount of companies' liabilities under loans and their liabilities under loans provided by the financial sector.

Fiscal sector

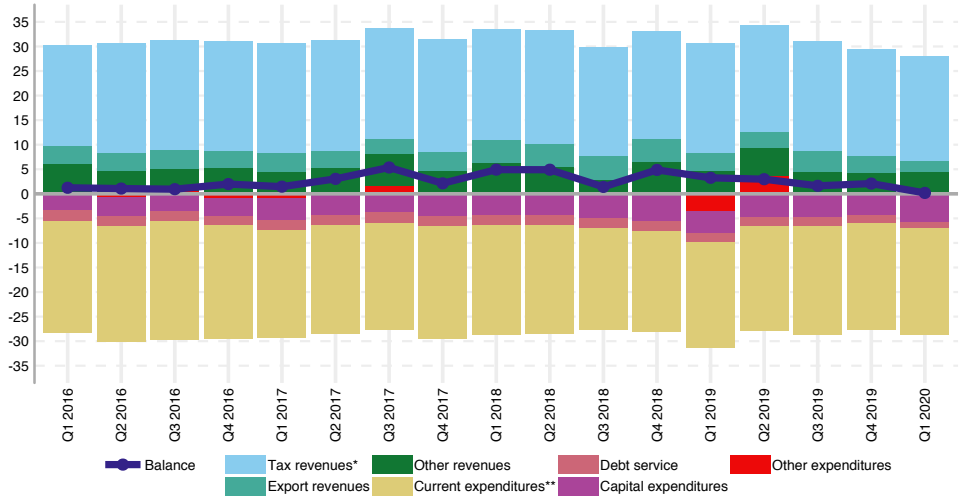
A fiscal deficit is emerging

The budget for 2020 was initially approved with a deficit. The key reason for that was a decline in revenues associated with oil and petroleum product trade arrangements. Under the original parameters, the consolidated budget deficit was to stay under 1% of GDP, which would allow it to be easily financed with accumulated reserves. Moreover, the budget scenario, which appeared conservative, gave the hope that the de facto situation would be better than planned. However, almost all the revenue shortfalls reflected in the plan began to materialize. Moreover, the coronacrisis resulted in a number of additional unforeseen revenue shortfalls. Finally, a need for higher spending, inter alia, related to supporting state-owned enterprises, arose and has been getting stronger. Therefore, the situation in the fiscal sector began to undergo qualitative changes. A fiscal deficit is emerging for the first time in many years, and the situation in the fiscal sector is unsustainable.

The public debt burden is on the upward trend

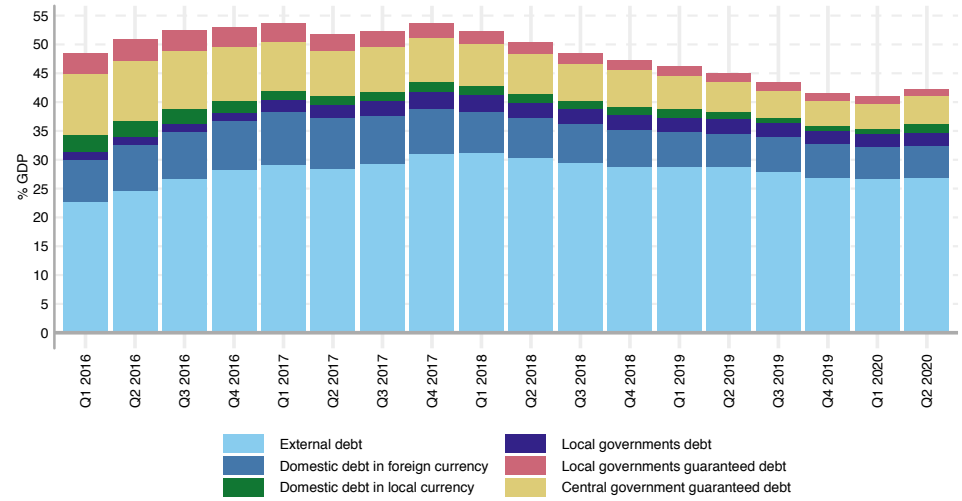
The period of smooth reduction of the debt burden has ended. The upward trend was set by the BYN depreciation—almost 100% of the public debt is denominated in foreign currency—and the decline of the GDP amidst the coronacrisis. Moreover, the needs for foreign exchange, as well as the growing budget deficit, are pushing the authorities to mobilize new debts more actively. In Q2, USD 1.4 billion was raised through new bond issues.

Consolidated budget performance, % GDP



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

Public debt, %GDP



Note: Quarter average.

External sector

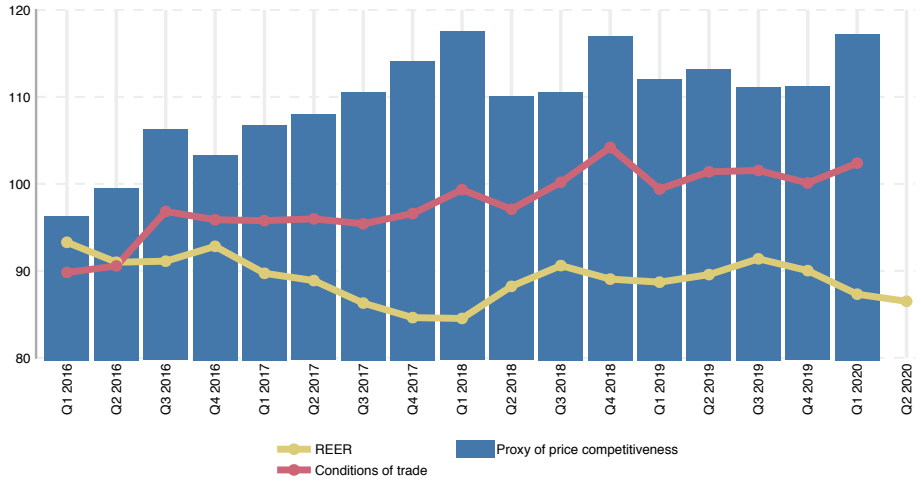
The terms of trade are relatively favorable, but BYN continues to depreciate

In the first six months of the year, prices in foreign markets were steadily decreasing. However, the ratio of export and import prices was quite unstable for Belarus. In Q1 and early Q2, the decline of import prices outpaced that of export prices. In many ways, that was due to a sharp drop of the price of oil. As a result, the terms of trade for Belarus even improved. The relatively favorable terms of trade are seen as an important factor for maintaining the external stability. For the time being, it favorably distinguishes the external environment from that of the 2015-2016 recession. However, in the middle of Q2, the dynamics of the terms of trade became less favorable for Belarus. Against that background, the external price competitiveness was additionally backed by the trend of the BYN real depreciation, which was getting steady.

Global recession and future uncertainty

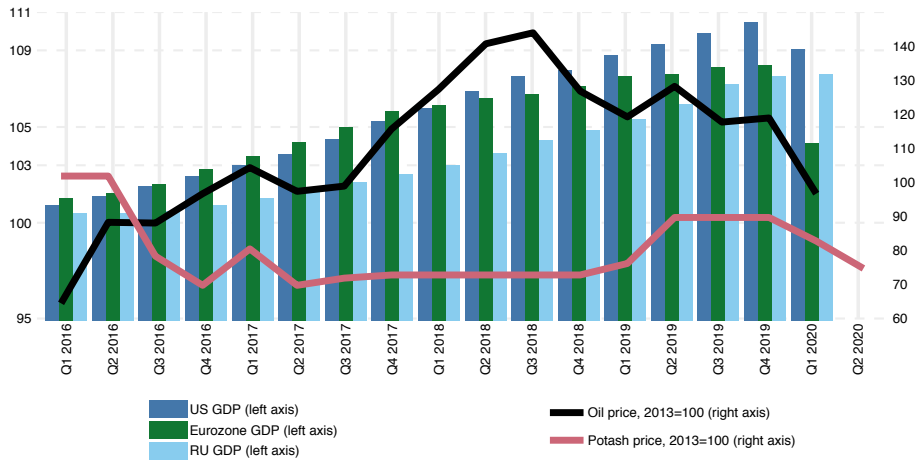
In the context of the coronavirus pandemic, all major economies in the world have experienced a decline of GDP. In Q1, it was not so large in most developed countries (1-4%), but in Q2, it deepened significantly and is tentatively estimated at 5-17% for different countries. In Q3, against the background of restriction easing, the trend of recovery is expected to dominate in the global economy. However, the threat of a second wave of coronavirus and the imbalances and tensions accumulated globally contribute to further excessive uncertainty even about short-term global economic prospects.

External price competitiveness indices, 2015=100



Note: The price competitiveness index is calculated as the product of the terms of trade index and the reverse REER index, multiplied by 100.

Global economic indicators, 2015=100



Note: All the GDP series are seasonally adjusted. The commodity price indices are calculated based on the World Bank data.

External operations

The volume of trade has shrunk, but the external equilibrium has been maintained

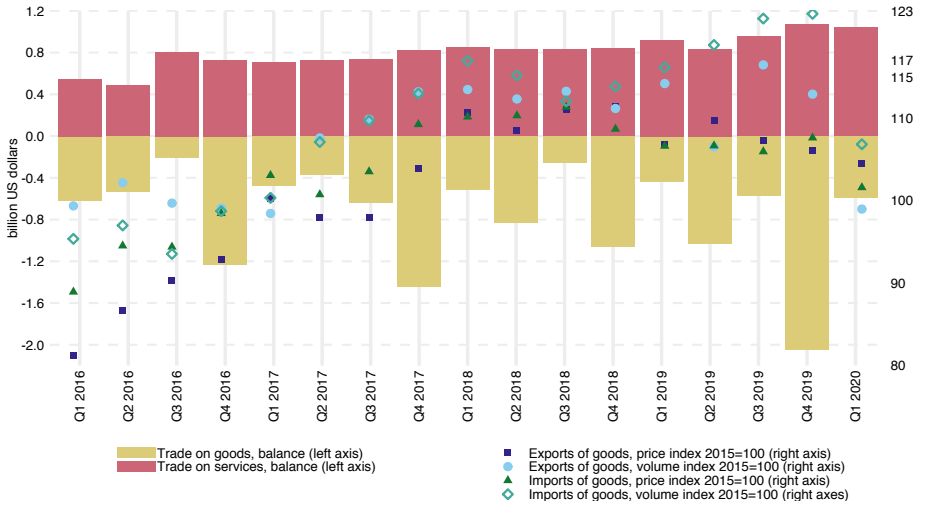
In the context of the coronavirus pandemic, the external demand predictably weakened. However, the magnitude of that weakening was not so great compared to potential scenarios. At the time when the most severe restrictions were in force (in April-May), the physical volume of exports dropped by about 11%. The greatest decline was registered for investment goods and energy. At the same time, the external demand for food consumer goods increased, which had a stabilizing effect on exports.

Unlike previous episodes of plummeting external demand (in 2015-2016), that did not result in a deterioration of the trade balance. The reasons for this included the relatively favorable price terms, as well as the compression of the physical volume of imports. The physical volume of imports decreased significantly across all groups of goods, except investment ones.

New loans in adverse financial conditions

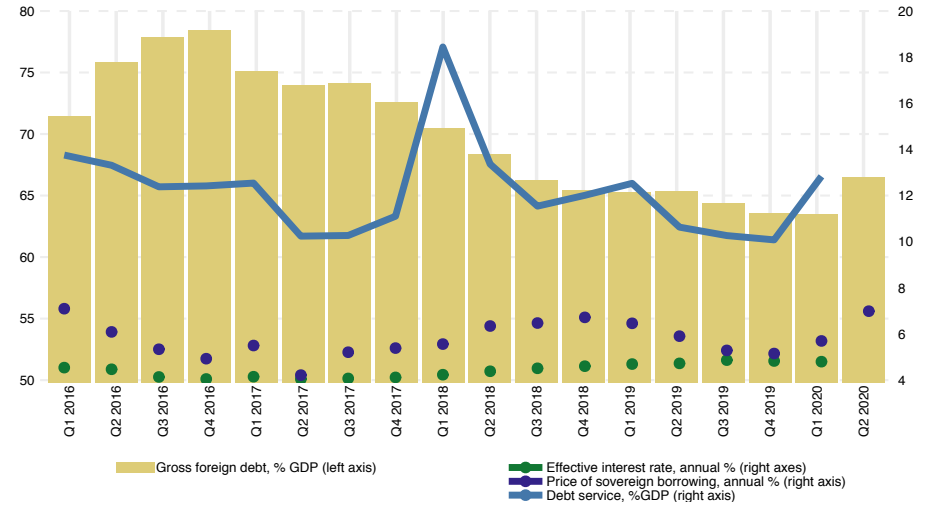
In Q2, against the background of perturbations in the world economy, the cost of borrowing for Belarus—as well as for all emerging economies—increased significantly. Despite that, the authorities mobilized new borrowings by issuing foreign and euro bonds to improve the foreign exchange liquidity position.

Prices and volume of international trade, 2015=100



Note: PI – price index; PVI – physical volume index. The indices are seasonally adjusted. The balance of trade is not.

Volume and price of foreign borrowings



Note: Debt service data in % of GDP include both interest payments and principal repayments. The effective interest rate is calculated as a ratio of public debt interest payments over the last 4 quarters to the average public debt size over that period. The cost of sovereign borrowings is an estimate calculated as the average yield to maturity for all sovereign Eurobonds outstanding at the time of calculation.

Social sphere

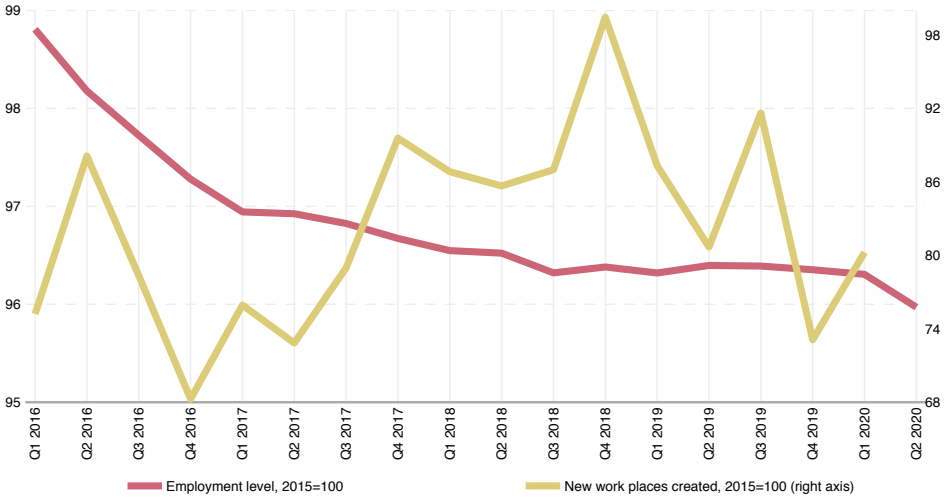
Employment is down, wages are up

Despite the coronavirus outbreak, real wages in the economy continued growing at a modest pace. The reasons for that included maintaining the production at state-owned enterprises, as well as expanding the related budget spending. However, the employment in the economy began to decline and the unemployment rate got to rise. The latter indicates that, despite the persistence of the wage growth, there are significant challenges in the labor market, reflecting the imbalances accumulated in the economy. For example, the real unit labor cost has significantly exceeded its long-term equilibrium level. This means that the current level of wages puts additional pressure on the price competitiveness of firms. With the top-down control of wages in place, one could expect that enterprises would respond by limiting employment, especially in the state-owned sector.

Inconsistencies in income policy

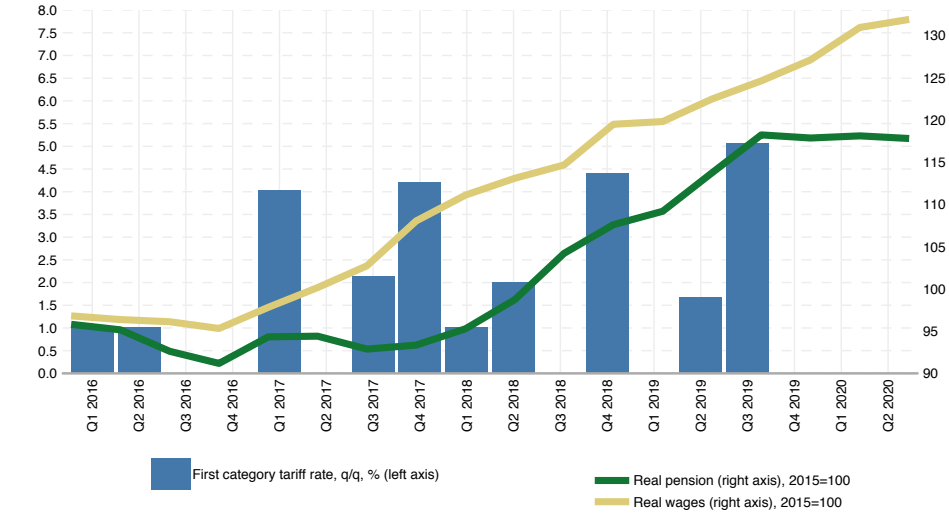
The size of social transfers remained unchanged in real terms in the first six months of the year. So did the poverty rate (3.4%). However, the authorities are hardly comfortable with preserving the current situation. Although, income disparities have been significantly reduced over the last two years, the authorities have not yet been able to fully restore an acceptable level of the relative well-being (following 2015-2016). Therefore, they seek to boost social transfers to improve the social standards, but the mounting fiscal challenges limit their ability to follow such policies.

Employment and new jobs, 2015=100



Note: The indices are seasonally adjusted.

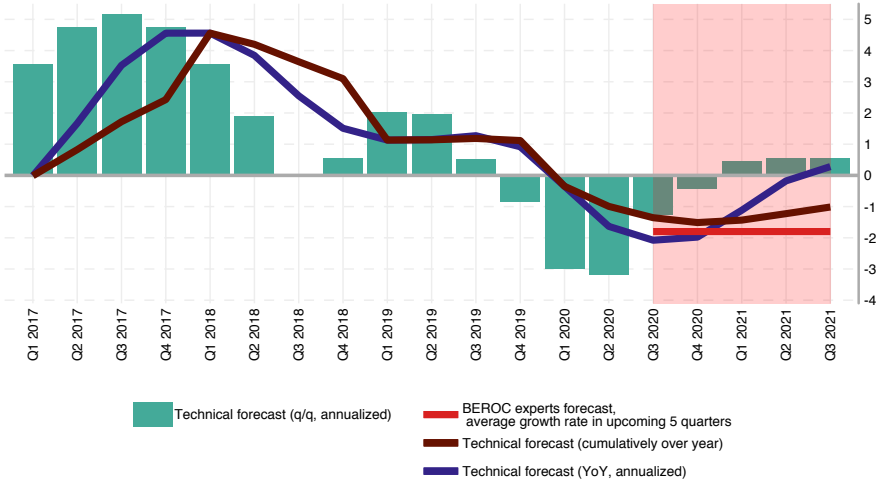
First category tariff rate and household income



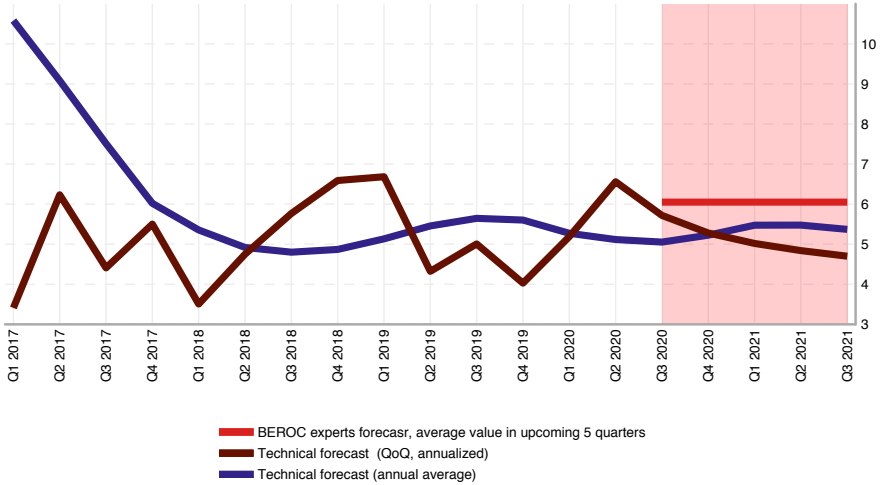
Note: The indices are seasonally adjusted.

Technical forecast

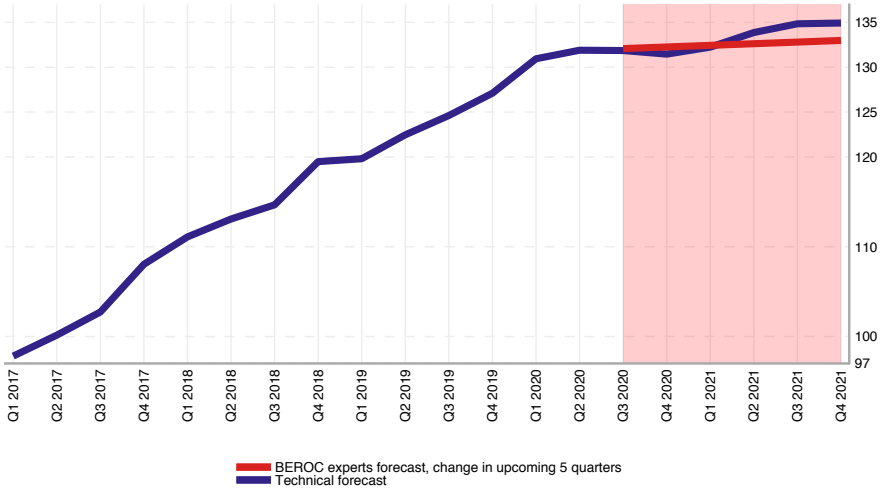
Output growth, quarter on quarter, % (annualized)



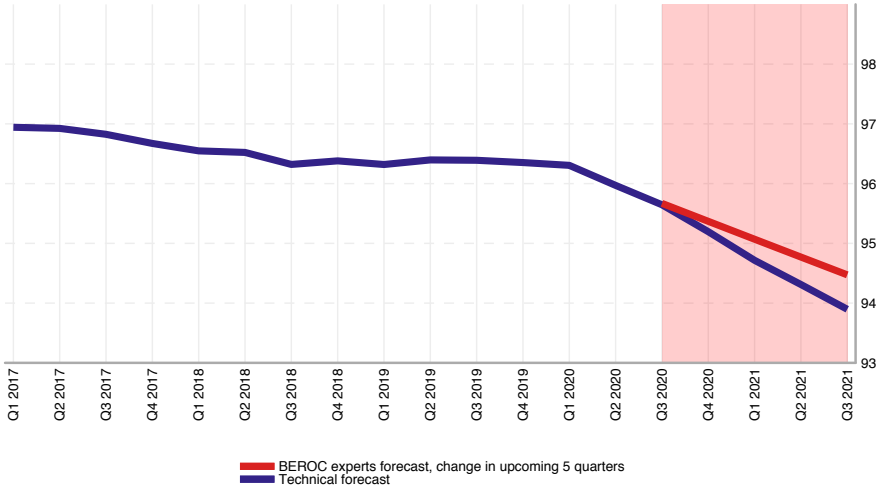
Inflation rate, annual average, %



Real wages, 2015 =100



Employment, 2015 = 100



The technical forecast is an automated procedure that selects the best specification of ARIMA model for a certain dataset based on the Akaike information criterion and employs this model for forecasting for 5 upcoming quarters. An ARIMA-based forecast just takes into account past trends of the selected indicator and doesn't consider other economic variables, either in the past or in the future. The term "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 to a particular indicator in the short-run, provided that the baseline scenario is applied, i.e. in case the fundamental parameters of the economic environment don't change, no exogenous shocks impact the economy, and fiscal and monetary policies remain unchanged compared to the current period?" BEROC's judgmental forecast shows the medium-term equilibrium of a relevant indicator, to which the latter would gravitate in the coming 5 quarters.

© BEROC 2020. All rights reserved.

This publication is published under the editorial responsibility of **Dzmitry Kruk** and **Dzmitry Kolkin**.

BEROC is registered as a Belarusian non-profit organization under the number 192554014, with registered address at Prospekt Gazety Pravda 11Б, Minsk, Belarus.

The electronic version of the publication is available on BEROC's website www.beroc.by

The publication draws upon information and data of the following:

National Statistical Committee of the Republic of Belarus (www.belstat.gov.by)

Ministry of Finance of the Republic of Belarus (www.minfin.gov.by)

National Bank of the Republic of Belarus (www.nbrb.by)

International Monetary Fund (www.imf.org)

R Core Team (2017). R: A language and environment for statistical computing. R Foundation for Statistical Computing, Vienna, Austria. URL https://www.R-project.org/.

Please forward your comments or suggestions to **beroc@beroc.by**

Prospekt Gazety Pravda 11Б, Minsk, Belarus

Phone +375 17 272 20 91

beroc@beroc.by

www.beroc.by