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Belarusian Economic Research
and Outreach Center



Economic Outlook

Third Quarter 2017

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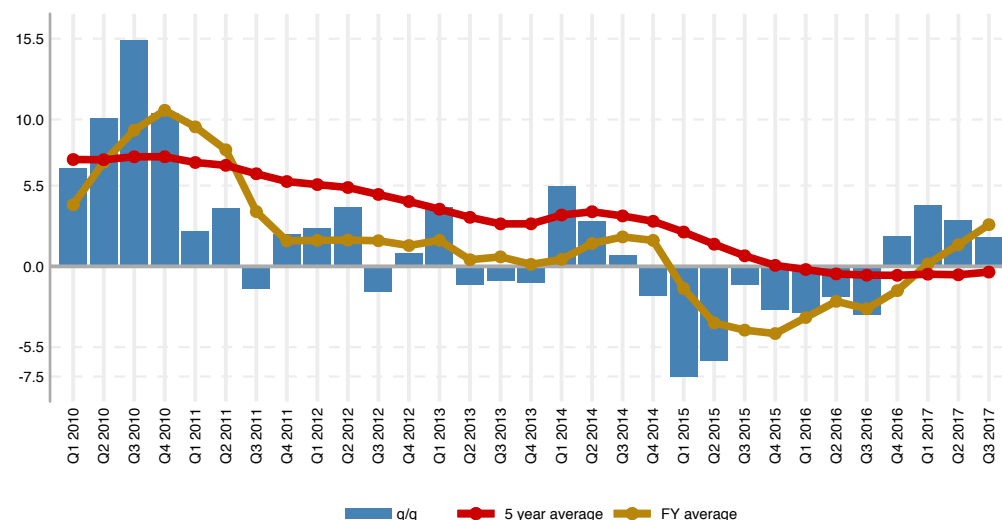
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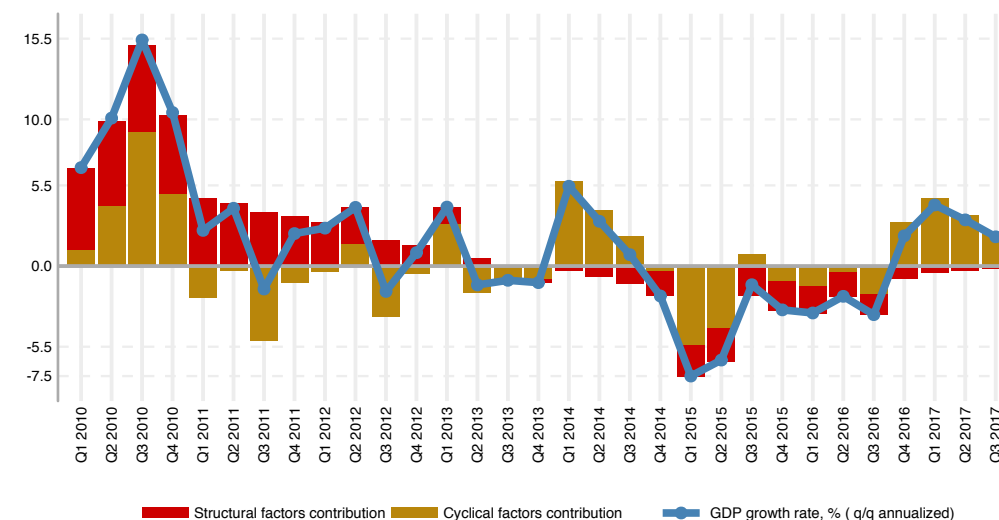
Drifting To Price Stability With Low Output Growth

- Growth slowdown signals are amplified
- The consumption growth is subsiding
- The growing return on capital can revive investment demand
- The inflation is drifting to the price stability zone
- The public debt structure is changing
- Real wages are growing, but the real well-being is stagnating

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).

Main trends

Price stability and external equilibrium have been notionally achieved. However, output growth, its sustainability, and financial stability remain questionable.

In 2017, a few favorable changes occurred in the macroeconomic environment of Belarus. First, the inflation has reached its historic lows and demonstrates relative stability. Secondly, the current account and the balance of payments in general are close to the equilibrium level. These developments can be classified as achievement of price stability and external equilibrium. However, it should be noted that they are approximately equally caused by changes in the economic policies and the economic recession of 2015-2016. Therefore, if there is output growth, maintaining the price stability and external equilibrium will not be guaranteed in future. Given this reservation, it is worth talking rather about notional achievement of the price stability and external equilibrium.

However, the other two components of the macroeconomic stability — sustainable output growth and financial stability — remain unattainable. The output pattern observed in Q3 signals that the strength of economic recovery is ebbing away, and the GDP growth has “hit its ceiling.” This gives reason to expect that in 2018 the output growth will either stabilize within the range of 2-2.5%, or even start to show a downward trend. A more favorable output pattern will be demonstrated only in case of a new round of export growth, but so far there have been few prerequisites for that.

The financial instability associated with the low quality of private debts and high levels of public debt still poses a serious threat to the economy. In 2016 - early 2017, the authorities tried to formulate a systemic response to neutralize the threat. However, these attempts had not led to any tangible results by the end of 2017. Measures that could “launch the process” of resolving debt-related issues are usually unacceptable for the authorities for social and political reasons. Thus, only “half-measures” have been taken so far to “freeze” the problem and limit its negative impact on the current macroeconomic developments. In future, the “debt overhang” can manifest itself at any moment of time, leading to a new wave of economic recession.

In this situation, the most likely economic development scenario for the medium term is low output growth combined with permanent recession risks, but with the price stability and external equilibrium maintained. This scenario, however, can be replaced with a less optimistic one. If the artificial stimulation of wage growth, which took place in the second half of 2017, continues in 2018, the low output growth would be aggravated by accelerated inflation, which would move out of the price stability zone.

Informational background

The issue of bad debts and state-owned enterprise rehabilitation has been “put on the back burner”

In late 2017, the authorities tried to intensify the resolution of the problem of “bad debts.” Some indicators, characterizing the results of implementing a package of “mild” measures to distressed debtors in the agricultural sector, have been made public – since 2016, the authorities have been trying to restore the solvency of most of them. Despite the additional easing, only about 10% of 323 agricultural enterprises have been able to restore their solvency. This case could evidence the fact that the “treatment” of distressed debtors is difficult, and their “recovery” is hardly realistic.

By now, two alternatives have emerged for further actions: to supplement the “mild approach” with new measures to support debtors, or to shift the focus to more radical, but effective measures. As an illustration, the latter include strengthening creditor rights, giving the “green light” to the procedure of bankruptcy of heavily indebted state-owned enterprises, granting the right to sell debts at their fair market rather than nominal value, etc. Reinforcement of the “mild approach” would call for new subsidies from the state and looks hardly promising. The “tough approach” is fraught with a major upheaval in the real sector, as well as social and political consequences. The authorities have been unable to make a strategic decision and choose the alternative that would be acceptable. Thus, the problem has remained suspended and still represents a threat to the financial stability.

The authorities improve the doing business environment to boost economic growth

In the second half of 2017, the authorities adopted a package of regulatory documents designed to promote the development of private businesses. The legislative novelties make it much easier to do business by drastically reducing the regulatory and administrative barriers to it. Additional tax and administrative privileges are also introduced for some activities, which are often handled by small companies and individual entrepreneurs. Finally, the opportunities for self-employment of individuals, without registration of small businesses, for example, in the sphere of handicrafts and agroecotourism, are expanded. The measures taken will certainly be instrumental in promoting the private sector development. In addition, self-employment mechanisms can contribute to the labor market stabilization and become an “integrated shock absorber” for this market in the future.

It is important, however, to note that the key barrier to the private business development is not the regulatory environment, but the de facto unlevelled playing field for competing with state-owned enterprises. In this respect, the artificial “imbalance” in the allocation of resources in favor of the state-owned sector is especially grave. If this “imbalance” is not eliminated, the private sector would be unable to fully realize its potential. Therefore, the measures aimed at developing the private sector and not supported by abandonment of the artificial support of state-owned enterprises will have only a limited effect.

Output and demand

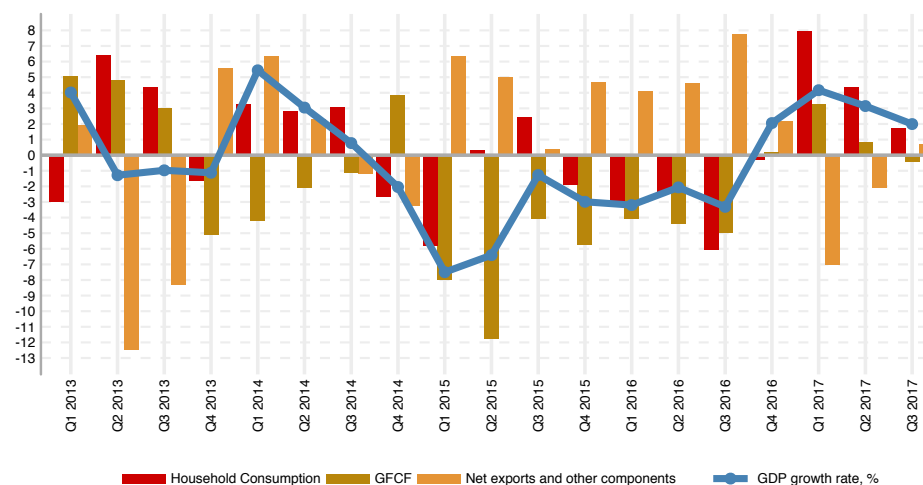
The consumption growth is subsiding

In Q3 2017, household consumption remained the leading contributor to the aggregate demand growth. However, this growth slowed down significantly compared to the previous two quarters. It suggests that the period of rapid recovery growth of household expenses on consumption is coming to its end, falling under the influence of the “built-in stabilizer” of the floating exchange rate. Under the floating exchange rate regime, domestic demand components can demonstrate sustained growth (since their growth inevitably and significantly boosts imports) only being “backed up” by exports growth. Otherwise, the deterioration of net exports would lead to exchange rate depreciation and rising prices, limiting real incomes and domestic demand.

The growing return on capital can revive investment demand

The long period — about 4 years — of investment depression in the domestic economy has caused a drastic reduction in the share of investments in GDP: this indicator has fallen from its peak of about 40% in 2010 to about 25%. The lower level of investments has also raised their quality, as one can expect that mainly less effective projects were cut off. The past quantitative and qualitative “cleanup” explains the growing return on capital, which is probably the harbinger of the investment depression end.

Contribution to output growth, percentage points



Note: The growth rate of GDP is provided on annualized quarter on quarter basis with a seasonal adjustment; GFCF – gross fixed capital formation.

Quality growth indicators



Note: The proxy for the return on capital is calculated as the relationship between annual average output growth and share of GFCF in GDP.

Monetary sector

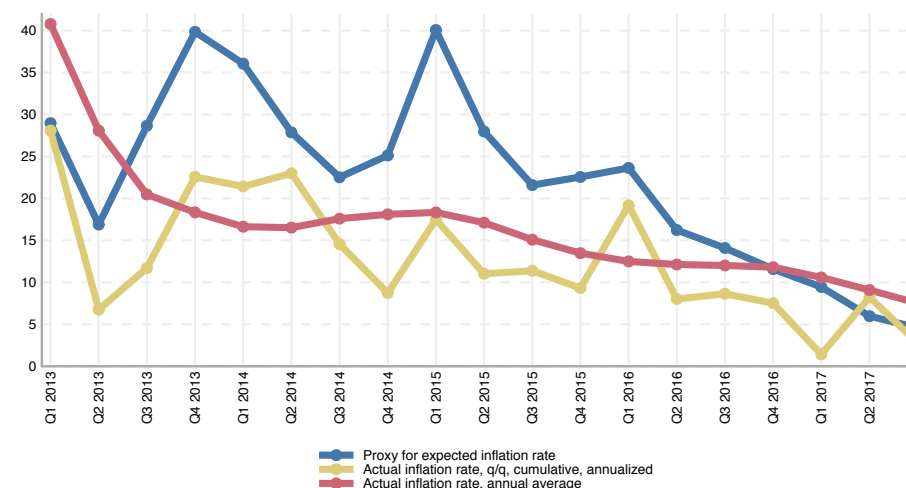
Drifting to price stability

In Q3 2017, the favorable price pattern remained, and some of the inflation indicators sank to their new record lows. The relatively long period (6 quarters) of (quarterly) inflation below 10% gives grounds to state that the inflation has not just decreased, but is getting sustainable. With certain reservations, this trend can be interpreted as a drift to price stability.

Confidence in local currency is increasing, albeit too flabbily

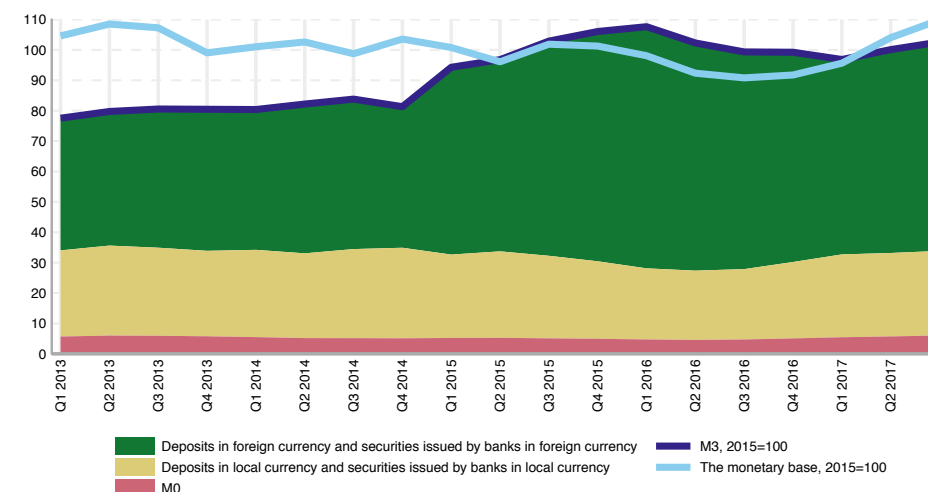
The steady disinflation has led to subsiding inflation expectations. However, the claims that they are stable and controlled by the National Bank still raise doubts — this is confirmed by the results of the household survey conducted by the National Bank. Similar contradictions can be traced in the broad money composition. On the one hand, the share of cash and BYN deposits has been growing for 6 quarters in a row. But, on the other hand, this growth noticeably weakened in 2017, although the money supply composition is still far from “normal.” This trend can be interpreted as a recovery of confidence in the local currency, albeit very flabby and stressing the fragility of the price stability. From this point of view, the relaxation of the National Bank’s monetary policies — for instance, during the second half of 2017, the refinancing rate was reduced by 3 percentage points to 11% per annum, — may, post factum, be excessively rapid.

Inflation and inflation expectations %



Note: Inflation expectation proxy is calculated as difference between interest rates of new savings deposits and call deposits for individuals.

Monetary aggregates



Note: The components of Broad money (M3) correspond to the scale M3 in 2015=100. All the components are seasonally adjusted.

Fiscal sector

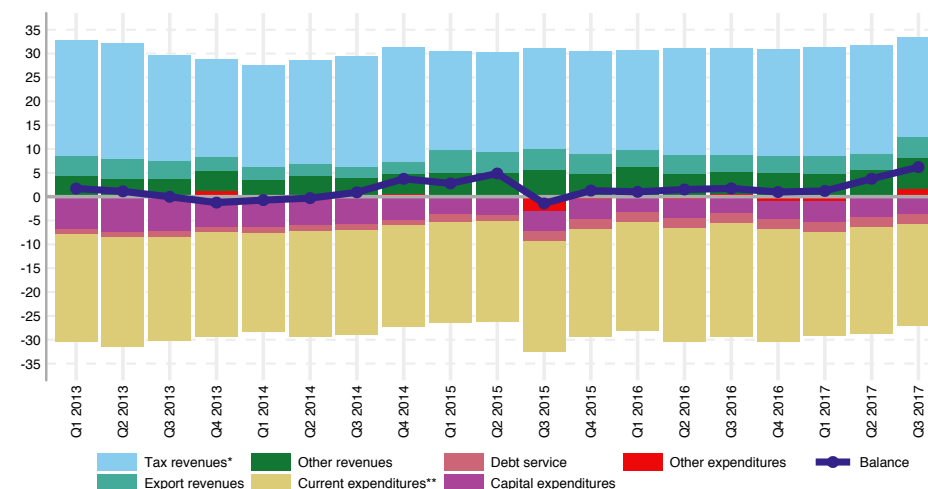
Lower budget loans, higher budget surplus

In Q3 2017, the consolidated budget surplus increased quite radically from 3.8% to 6.2% of GDP. As a result, the surplus accumulated over three quarters exceeds the planned annual amount, which is needed to make principal repayments on public debt, by the factor of 3.5. The key feature contributing to the sharp surplus growth was a decrease in expenditures by about 2.5% of GDP. Among those, the key element was the net repayment of budget loans, which made this expenditure item a de facto revenue one in Q3. Thus, the fiscal authorities have a certain “buffer” at their disposal. But it is unlikely to last for long, as the authorities intend to use it to ensure wage growth in the budget sector.

The augmented public debt is fluctuating within the range of 45-50% of GDP, but its structure is changing

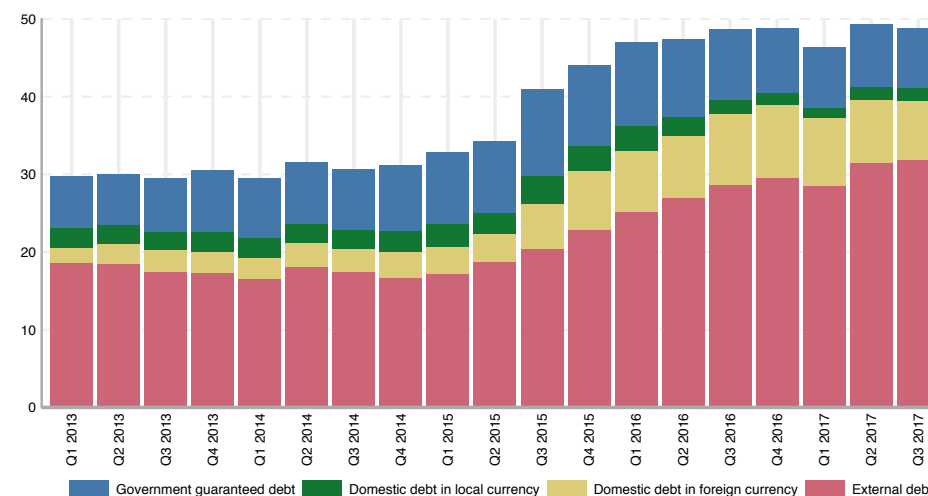
There has been a smooth drift in the public debt structure towards lower domestic debt denominated in foreign currencies. This part of the public debt has dropped from its peak level of 9.4% of GDP in Q4 2016 to 7.7% of GDP and is mainly associated with operations of the government related to buying out “bad” debts of state-owned enterprises in foreign exchange. The replacement of this part of the public debt with external debt attests to wrapping up the process of “repackaging” debts of state-owned enterprises as public debt. In addition, it also contributes to greater transparency of the public debt.

Consolidated budget performance, % GDP



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

Public debt, %GDP



Note: as of the beginning of the quarter.

External sector

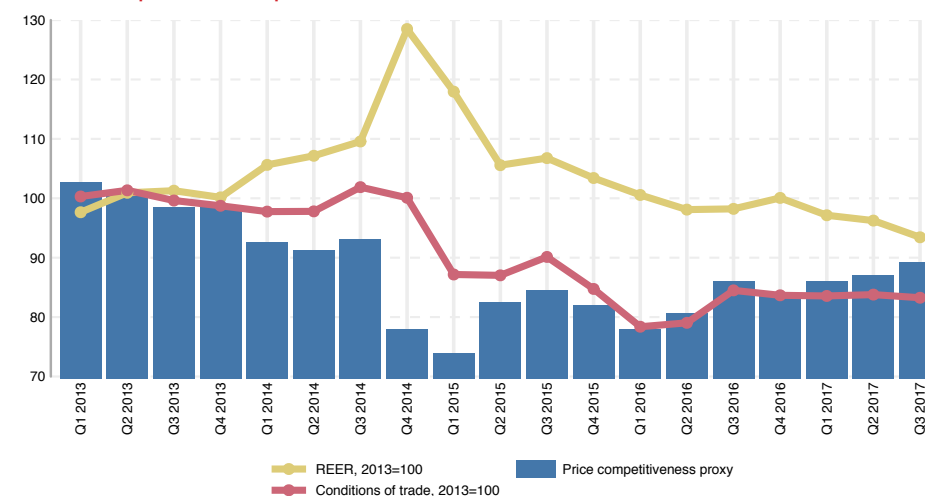
The real exchange rate feeds the price competitiveness

The terms of trade, i.e. the ratio of export and import prices, have remained almost unchanged for Belarusian firms for 5 quarters in a row. However, the price competitiveness of domestic producers continues to grow smoothly due to the real effective exchange rate depreciation. In addition to being currently a source of “fueling” the competitiveness, the real exchange rate also acts as an absorber for the shock associated with an artificial increase in wages.

The output recovery in Russia is questionable

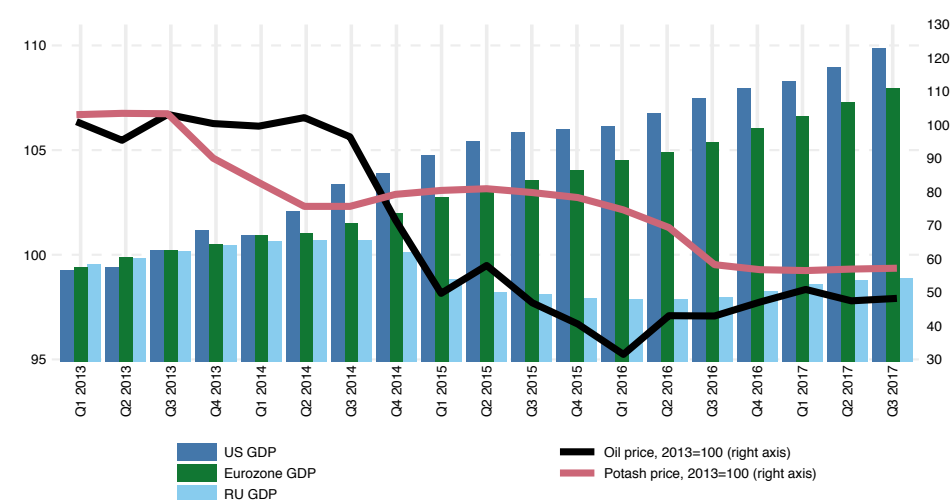
The world's largest economies continue to demonstrate fairly strong growth. However, in most cases, the growth is no longer accelerating, but generally stabilizing. The continued acceleration of growth in the United States is very likely to be soon replaced with the “calm.” Stable global growth helps revive demand for commodities. However, despite the favorable conditions, the economic pattern observed in one of Belarus' most important trade partners, Russia, sends contradictory signals. The slow output recovery, which began in 2016, practically fully ran out of steam in Q3 2017. This raises doubts not only about Russia entering the path of stable growth, but even about the prospects of off-setting the losses of the recent recession any time soon.

External price competitiveness indices, 2013 = 100



Note: Price competitiveness index is calculated as the product of trade conditions index and reversed REER index multiplied by 100.

Global economic indicators, 2013=100



Note: All GDP indicators are seasonally adjusted. Potash and oil price indices are calculated based on corresponding data in the World Bank Global Economic Monitor database.

External operations

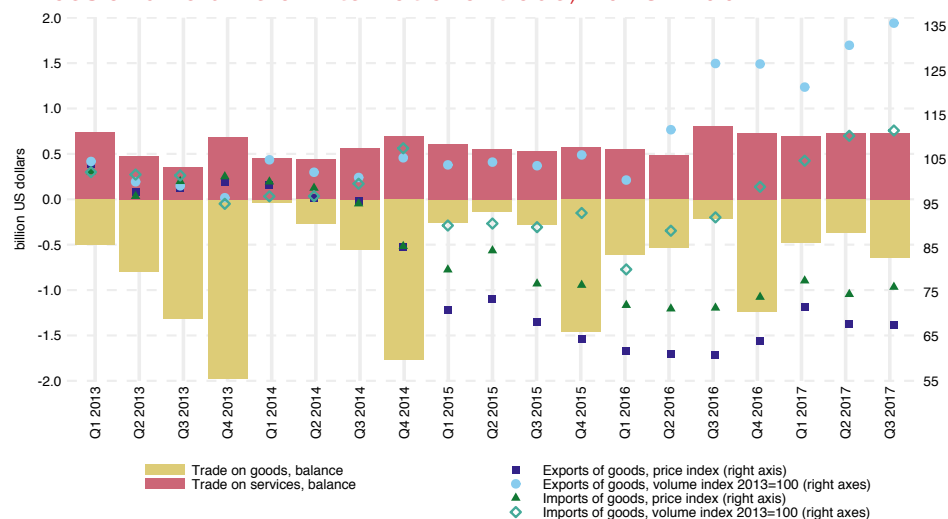
Imports have slowed down, exports have risen

In Q3 2017, the growth of the import physical volume slowed down in sharp contrast with the strengthening growth of the physical volume of exports. The pattern of imports was largely a result of the consumer demand “cooling”, for instance there was some “slow-down” of food imports. The revival of exports has given a positive impetus to the entire economy, but the growth remains fragile. Most of the commodity items have demonstrated oppositely directed moves in recent quarters. As an illustration, the physical volume of exports of the “growth leaders” registered in Q2 (oil products, potash fertilizers, tractors and trucks) subsided in Q3 2017, while exports of the former “underperformers” (food products, tires, refrigerators, footwear) increased. The volatile export growth is a challenge for the entire economy, as the prospects for output growth are highly dependent on exports.

The time of cheap borrowing is running out

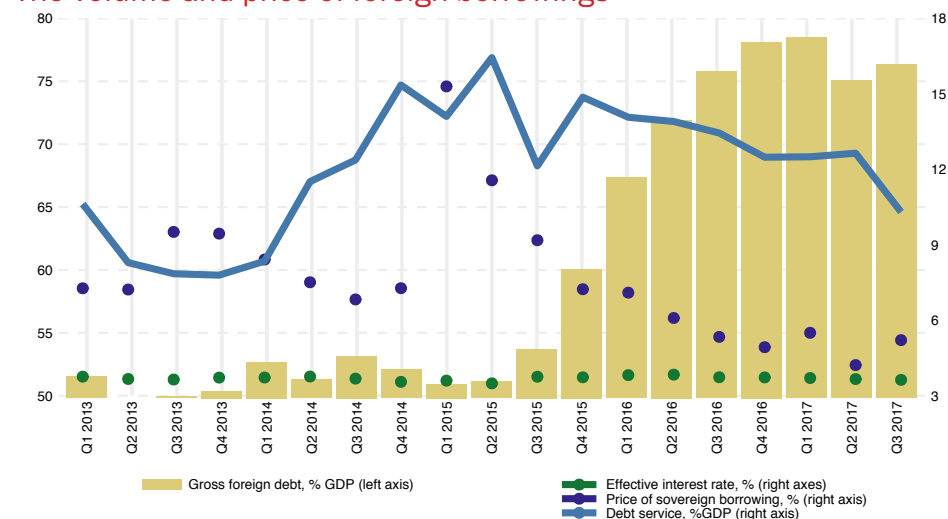
In Q3 2017, the price quotations for the new Belarusian Eurobonds (issued in June) were growing rapidly. The yield to maturity for 6-year bonds converged to 5%, and for 10-year ones – to 6% per annum (with the coupon yield of 6.875% and 7.625% respectively). This shows the attractiveness of Belarusian bonds against the background of low interest rates for first-class instruments. But in view of the global growth stabilization, it is likely that the benchmark interest rates will begin to grow soon. This will worsen the conditions and result in higher costs of borrowing for developing countries.

Prices and volume of international trade, 2013=100



Note: PI – price index; PVI – physical volume index. Indices are seasonally adjusted. Balance of trade in goods and services are not.

The volume and price of foreign borrowings



Note: debt service includes interest and principal payments. Effective interest rate is calculated as a ratio of interest paid during past 4 quarters and average amount of debt in this period. Price of sovereign borrowing – an estimate of the yield to maturity on all Belarusian Eurobonds outstanding.

Social sphere

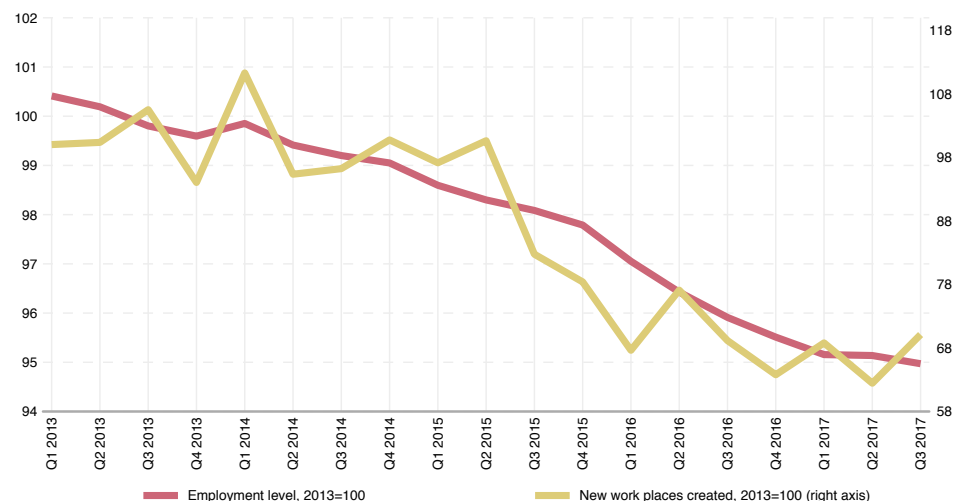
The labor market shows signs of stabilization

In Q3 2017, there were a few favorable trends in the labor market. Employment was growing in two out of three months. An important trend was also a tangible increase in the number of new jobs created. For the first time since 2014, the growth of this indicator was almost entirely natural (not administrative) in nature. This indicates that the focus of employers on cutting employment has weakened at the very least. In general, looking at the results of three quarters of 2017, we can note some stabilization of employment, which had been continuously declining since 2010.

Real wages are growing, but the real well-being is stagnating

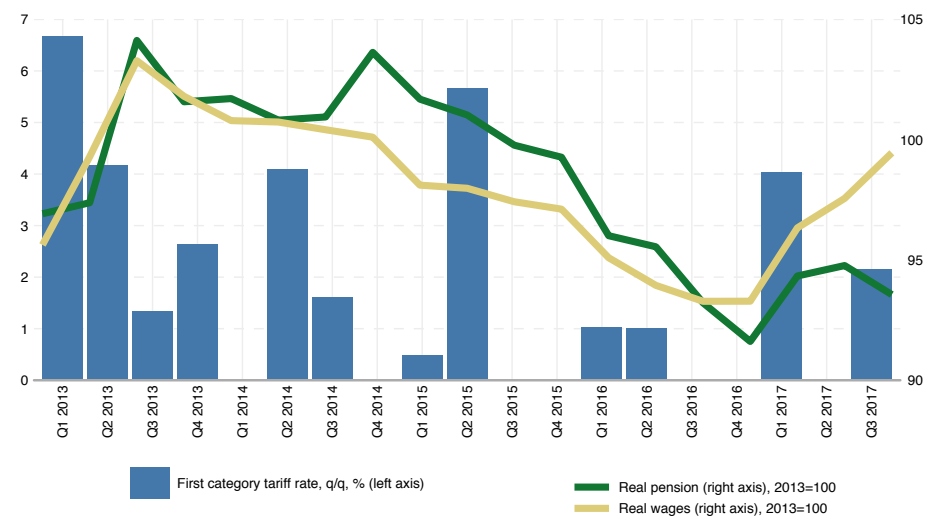
The real wage growth continued in the 3rd quarter. But since there is a great administrative component in this growth, questions about its limit and duration remain unanswered. At the same time, the wage growth is slowly turning into an increase in real incomes of the population, which began to show some modest growth only in Q3 (YoY), while in some regions, their fall continues. The poverty rate in Q3 remained at the level of the previous quarter, amounting to 5.9%. But, in the short term, it may be adversely affected by the growth of utility tariffs – since September, they have increased by an average of 8%; and another increase is planned in December. Thus, in the context of the weak economic growth, the quality of life of the most vulnerable segments of the population is not improving at the very least.

Employment and new working places



Note: Indices are seasonally adjusted

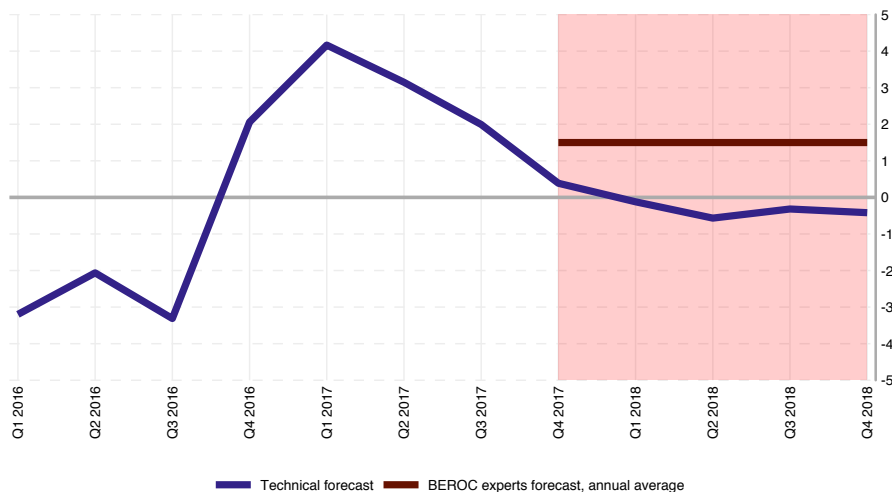
First category tariff rate and households income



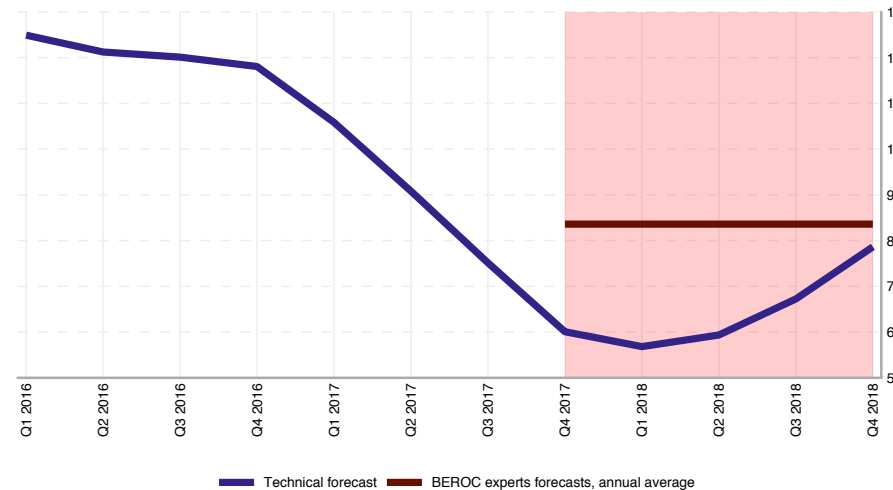
Note: Indices are seasonally adjusted

Technical forecast

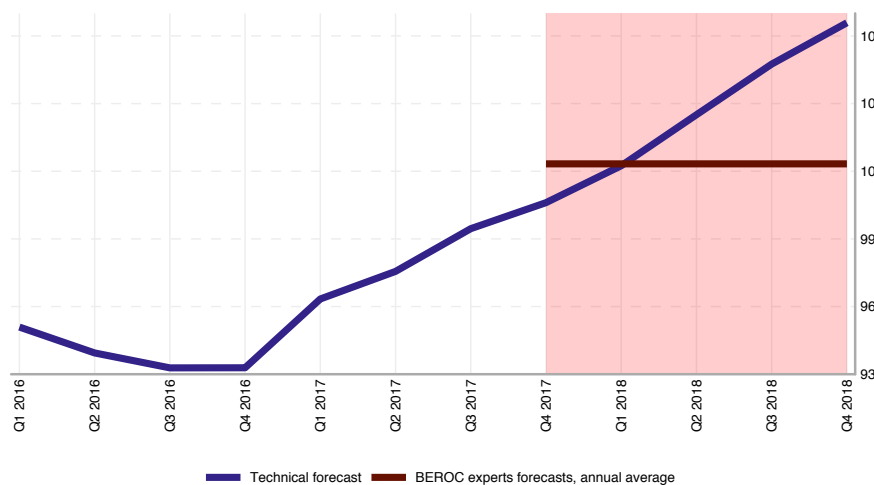
Output growth, quarter on quarter, % (annualized)



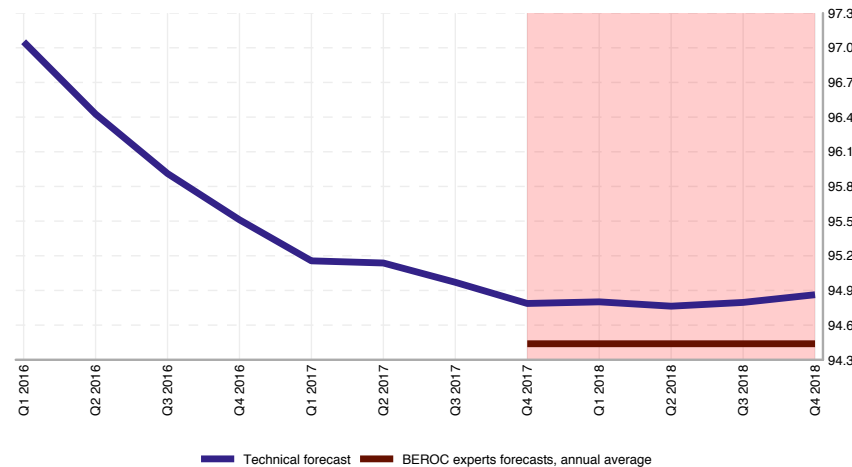
Inflation rate, annual average, %



Real wages, 2013 = 100



Employment, 2013 = 100



Technical forecast is an automated procedure that selects the best specification of ARIMA model for certain dataset based on Akaike information criterion (AIC) and employs this model for forecasting for 4 upcoming quarters. ARIMA-based forecast just takes into account past trends of selected indicator and doesn't consider other factors, neither in the past nor in the future. "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 with a particular indicator in a short-run period provided that inertial scenario is applied. That is, in case fundamental parameters of economic environment don't change, exogenous factors don't impact the environment and fiscal and monetary policies don't change either".

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International Monetary Fund (www.imf.org)

R Core Team (2016). R: A language and environment for statistical computing. R Foundation for Statistical Computing, Vienna, Austria. URL <https://www.R-project.org/>.

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