Research Report on Belarus

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Introduction

Belarus is characterized by a highly centralized economy and an authoritarian political regime. The country's proximity to Russia is not only geographical but also commercial and financial. Loose monetary policy and increase of wage enforced by the ruling government have generated a number imbalances in the country's economy. During the first month of 2015, the authorities implemented noticeable revisions of the monetary and wage policies by increasing the refinance rate of the National Bank of Belarus and announcing that wages will rise at the same pace as GDP this year. While such measures may generate better financial conditions for the country, they may be intended to provide short-term stability until the 2015 presidential elections. Current levels of government debt and fiscal deficit pose no significant risk to Belarus. However, the significant share of its external debt makes the country highly dependent on financial aid from partner countries and international finance organizations.

Main Economic Indicators of Belarus

Macro indicators	2012	2013	2014*
Gross pub. debt, bill BYR	203986	235614	265403
Nominal GDP, bill BYR	530356	636784	820356
Real GDP growth, %	1,73	0,89	0,94
Gross gov. debt/GDP,%	38,5	37,0	32,4
Deficit (surplus)/GDP,%	1,7	-0,9	-3,3
Inflation rate,%	21,8	16,5	18,4
Curr. Account balance/GDP,%	-2,9	-10,1	-8,5

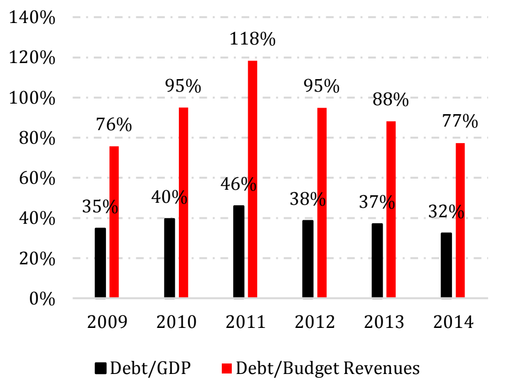
Development indicators	2014
Inequality adj. HDI	0,73
GDP per capita (Thou. of USD)	18,2

Sources: RAEX (Europe) calculations based on data from World Bank, IMF and Ministry of Finance of Belarus.
* Assessment of RAEX (Europe) based on current data provided by Ministry of Finance of Belarus and IMF.

Low levels of government debt load stand as one of the main strengths of Belarus, but external debt should be kept on watch. According to the figures published by the Ministry of finance of Belarus, gross government debt was 265 404 billions of BYR and accounted for 32% of GDP and 77% of budget revenues in 2014 (see graph 1). Except for 2011, when debt figure reached maximums of 118% of GDP and 46% of budget revenues, the aforementioned ratios have shown a downward trend over the past five years. Due to the significant amount of loans obtained from partner-countries like Russia as well as international finance organizations like the IMF, around 66% of total government debt (175 980 billions of BYR) was owed to external counterparties as of December 2014 (see graph 2). The amount of international reserve assets held by the National Bank of the Republic of Belarus (NBRB), which stood at 5,5 billions of USD as of February 2015, represents only 28% of total government debt and around 42% of external debt of Belarus. Under such circumstances, the dynamics of external debt will be closely monitored by this agency.

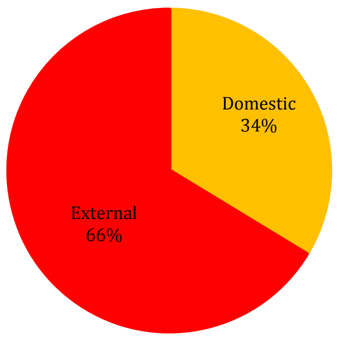
Noticeable changes in the wage policy were evidenced in recent months. For more than a decade the government of Belarus promoted

Graph 1: Gross government debt of Belarus



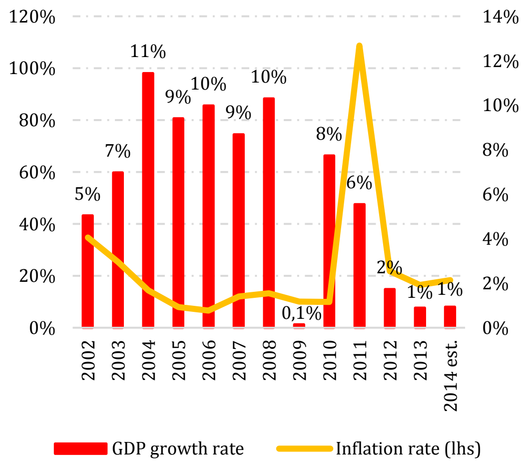
Source: RAEX (Europe) calculations based on data from IMF and Ministry of Finance of Belarus

Graph 2: Breakdown of government debt of Belarus (as of Dec 2014)



Source: RAEX (Europe) calculations based on data from Ministry of Finance of Belarus

Graph 3: Real GDP vs. Inflation



Source: RAEX (Europe) calculations based on data from IMF

a policy of wage increase which boosted domestic demand beyond the economy's productive capacity, generating inflation, fueling imports and decreasing competitiveness. The government's intentions behind wage targeting have always been to ensure growth in quantitative output indicators like production, profitability and exports. Such wage policy was successful at the first stages of its implementation as it boosted annual real GDP growth rates closer to 10% and pushed-down the inflation rate from 35% in 2002 to 13% in 2008 (see graph 3). Since the break-out of the 2008 financial crisis, and after production reached the installed capacity of the economy, the wage policy of the government started to show signs of deterioration. Given that the year 2014 ended with a GDP growth rate forecast of less than 1%, an inflation rate around 18% and significant workers' lay-off in some industries[1], government authorities decided that in 2015 wages will only grow at the same pace as GDP. While this is the very first step of the Belarusian government towards improvement of economic stability, it is still very soon to predict future developments of this policy, especially its impact after the 2015 presidential elections.

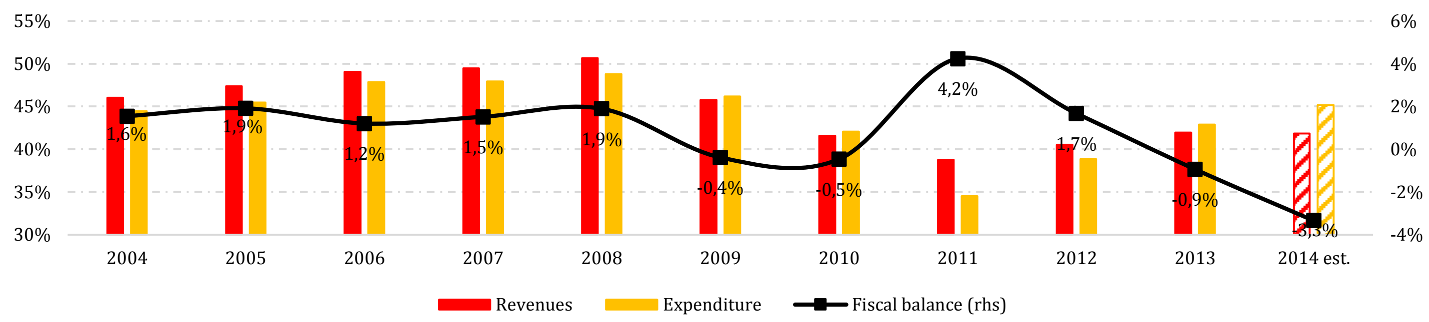
Dependence on Russia will play a major roll during 2015. Presidential elections are expected to take place in Belarus before November 2015. Given the intentions of the current president, Alexander Lukashenko, to run for another term in power, the government will have to make sure that economic and financial stability is granted in the country this year. In that respect, Belarusian authorities count on Russian financial assistance within the Belarus-Russia Union State, which would cover the repayment of 400 billion of USD that the government of Belarus has to face along this year. Additionally, Belarus expects to negotiate the possibility of unrestricted access of Belarusian goods to the Russian market as well as to obtain Russian guarantees to refrain from «trade wars» in 2015. So far, Russia has offered support to Belarus by allowing Belarusian enterprises to participate in the Russian import substitution program, but there were no official reports about Russia and Belarus reaching a loan agreement. Given that currently the government of Belarus lacks the funds to buy the loyalty of population through wage growth, financial and commercial support from Russia will prove crucial for the economic stability of the country and the electoral success of the ruling president.

Fiscal balance remains at tolerable levels despite showing a negative trend since 2011. During the period between 2004 and 2008,

[1] In 2014, the largest industrial enterprises (MAZ, BelAZ, Atlant, MTZ) laid-off up to 10% of their workers (according to Belarusian media).

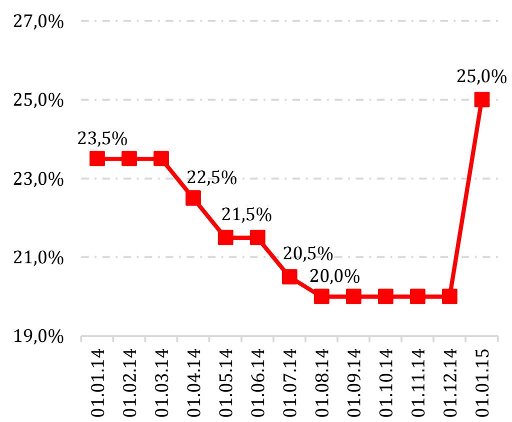
the government of Belarus showed a positive fiscal balance, which averaged 1,6% of GDP (see graph 4). In the years which followed the 2008 world financial crisis, fiscal balance became significantly volatile, ranging from a surplus above 4% of GDP in 2009 to a deficit higher than 3% in 2014. Additionally, the fiscal balance has been showing a negative trend since the outbreak of the 2011 currency crisis[2]. Based on the limited number of tools that the government currently has to obtain revenues, combined with the fact that government expenses are unlikely to decline during 2015 due to presidential campaign, this agency expects that such a negative trend in the fiscal balance will remain in place in years to come.

Graph 4: Fiscal position of the Belarusian government



Source: RAEX (Europe) calculations based on data from IMF

Graph 5: Refinance rate of the NBRB

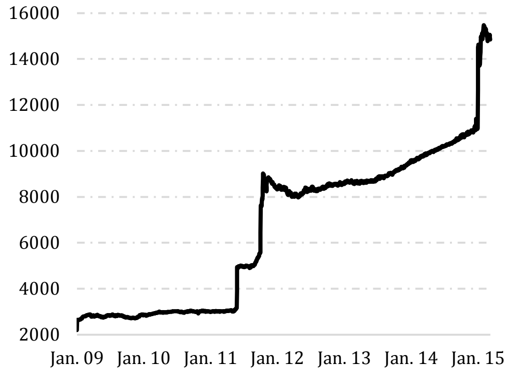


Source: RAEX (Europe) calculations based on data from NBRB

Even though the NBRB has recently enforced a number of measures to stabilize the financial sector, monetary policy still shows signs of poor performance. For the first time since 2011, the NBRB increased its refinancing rate in January 2015 by 5% (see graph 5). Additionally, the NBRB allowed the BYR to devaluate against the USD by almost 15% by bringing the exchange rate to 14 511 USD/BYR on the first day of January (see graph 6). While these decisions are expected to reduce the pressure on inflation rate and to increase short-term competitiveness of the economy, such sharp devaluation shocks do not help to reduce the high levels of dollarization. Additionally, the recent announcements of the NBRB about limits to operate in foreign currency[3] are expected to have strong negative effects on the trust of foreign investors.

[2] In January 2011 Belarusians started to convert their savings from Belarusian rubles to dollars and euros because there were rumors of possible devaluation of the BYR. This speculative attack on the national currency derived in a currency crisis in September 2011.
[3] In late December 2014, the NBRB, imposed a temporary 30% fee on the purchase of foreign currency for individuals and a mandatory sale of 50% (instead of the previously established 30%) of foreign currency earnings for exporters.

Graph 6: Exchange rate BRY vs USD



Source: RAEX (Europe) calculations based on data from NBRB

Conclusion

The large amount of imbalances that characterize the economy of Belarus has a significant negative impact on the overall creditworthiness of the country. While authorities have recently implemented a number of monetary and wage measures, these are expected to have only a short-term effect on the economic and financial stability of the country. Additionally, sharp and unexpected devaluations like the one observed at the beginning of the year counteract the efforts to preserve financial stability by fuelling the already high levels of dollarization. Given the intentions of the current president to run for another presidential term, the government is eager to obtain financial and commercial aid from partner-countries (like Russia) and international organizations. Even though the debt and fiscal positions of Belarus stand as one of the country's main strengths, the government can have future difficulties in honoring its external debt given the current amount of international reserves.