

Economy of Belarus: Crisis behind, crisis ahead?

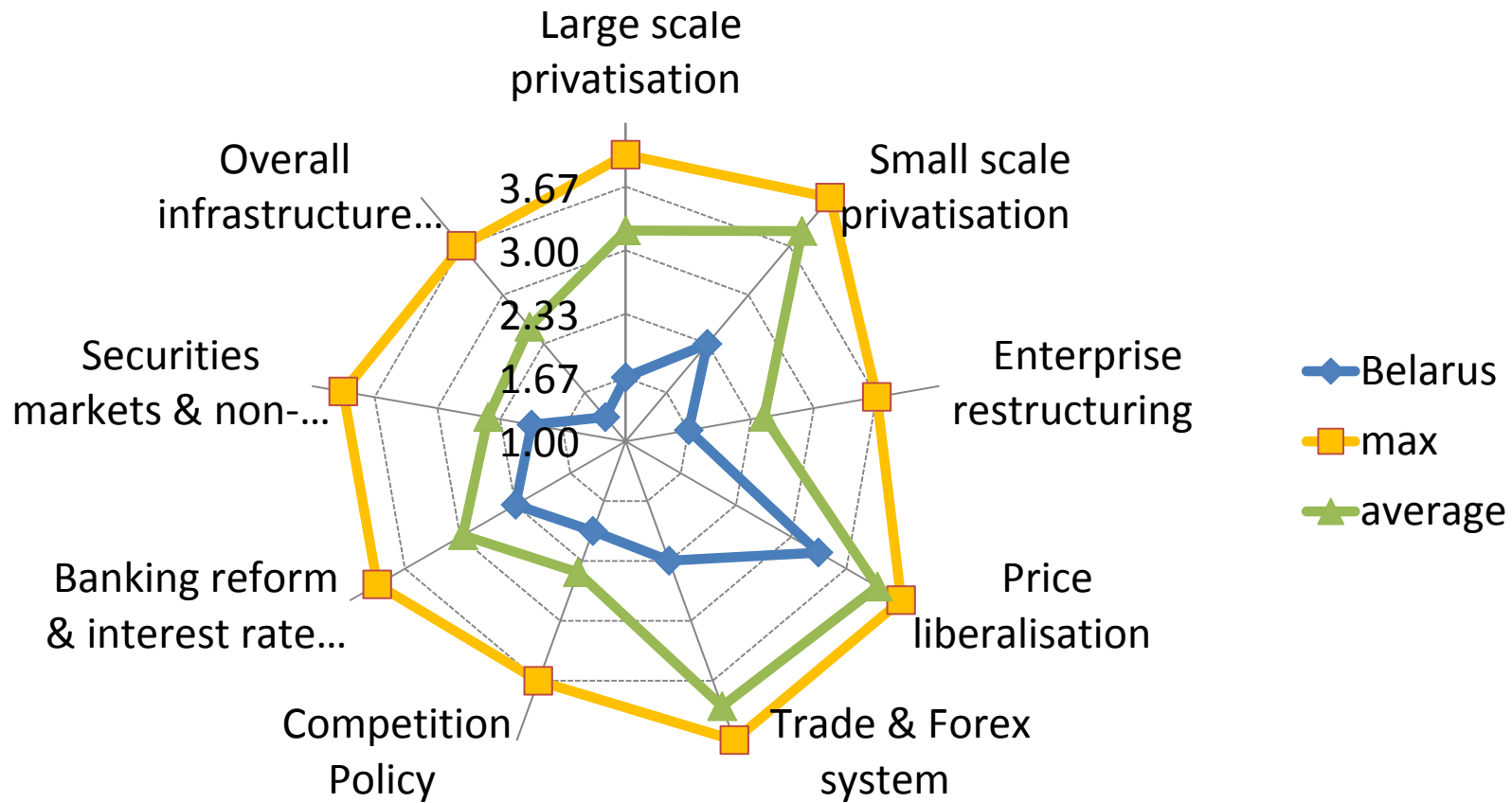
Alexander Chubrik

IPM Research Center / CASE – Center
for Social and Economic Research

Outline

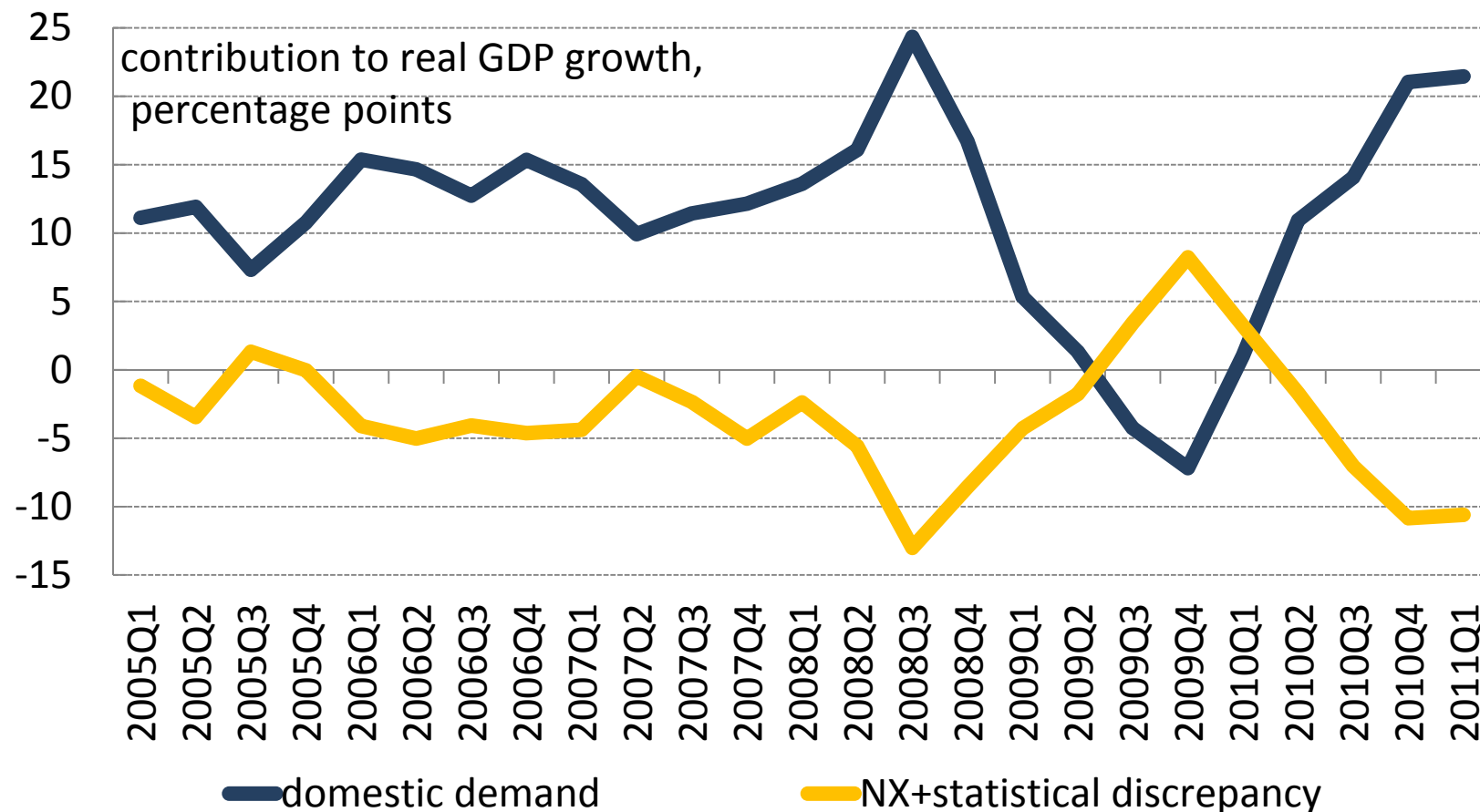
- Determinants of the crisis-2011;
- Economy in 2011: main macroeconomic trends;
- Policy options for 2012;
- Short-term outlook.

Outsider in terms of transition



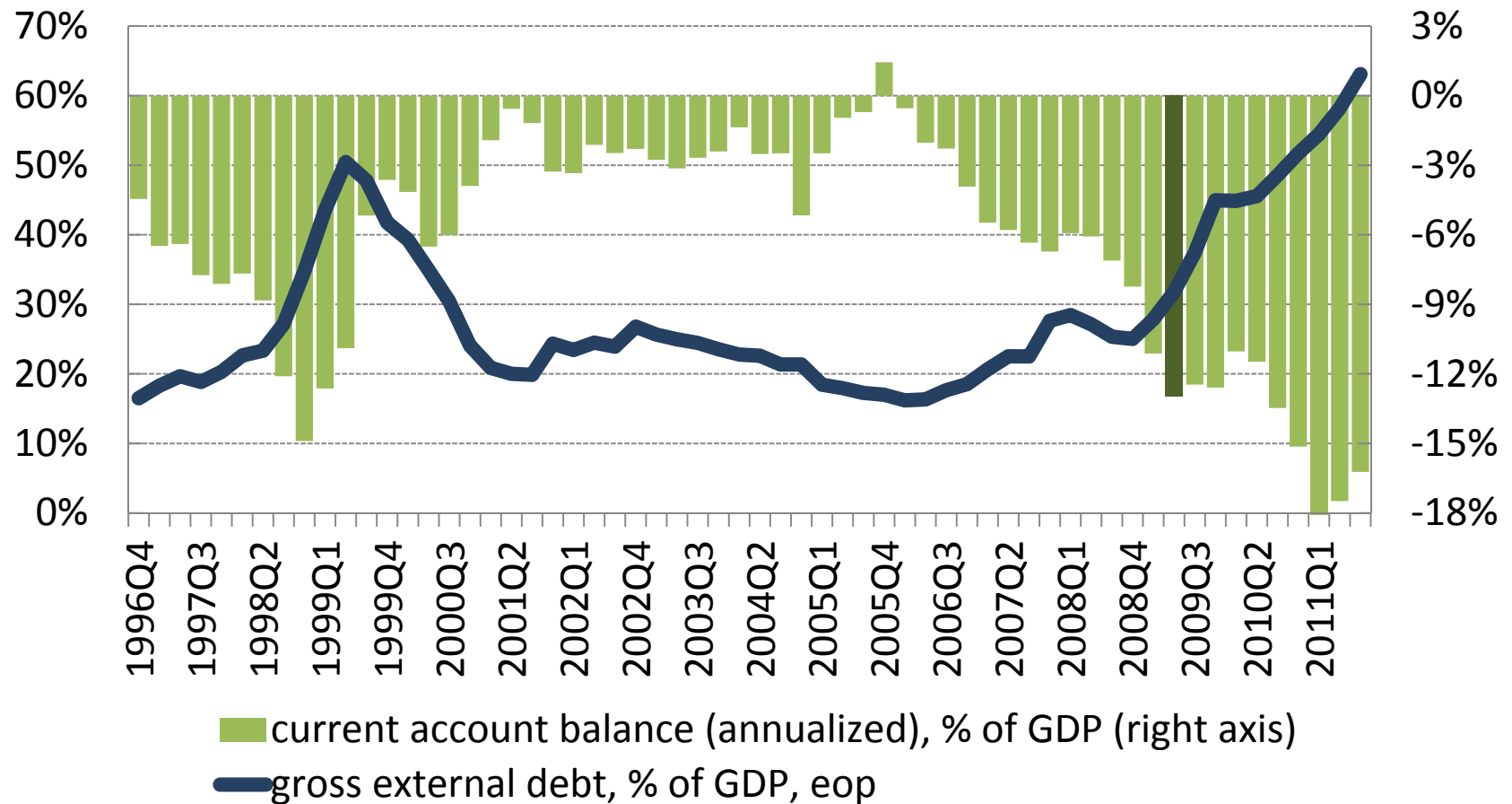
Source: EBRD (data for 2010).

Boosting domestic demand suppressed exports and enhanced imports



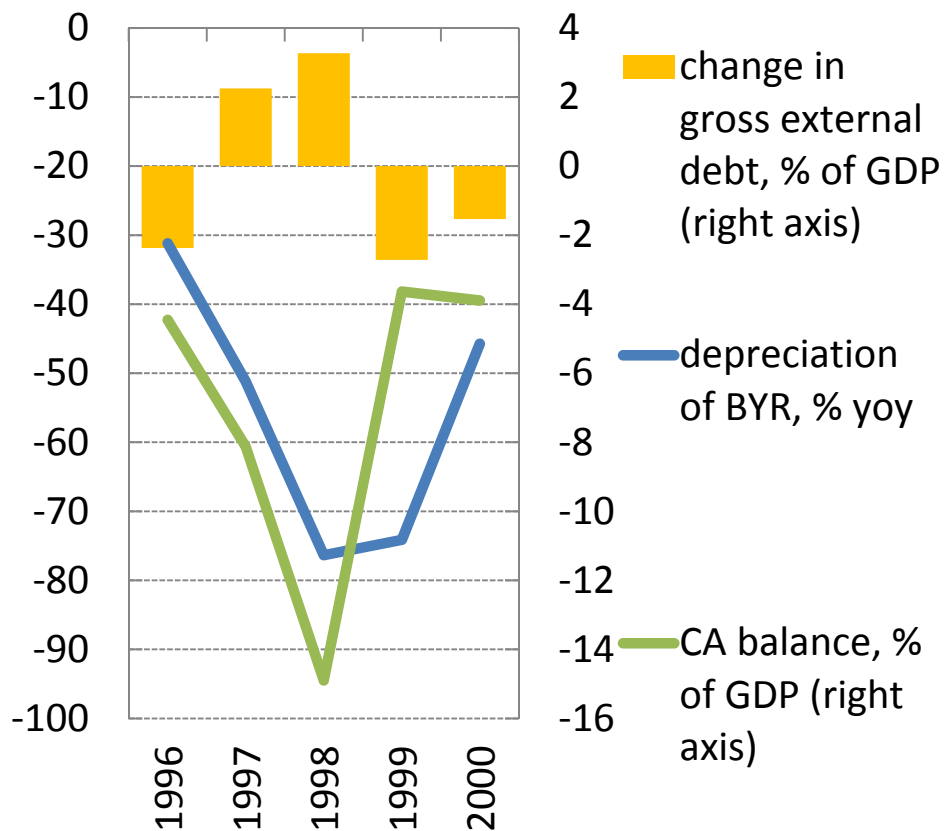
Source: own estimates based on Belstat data.

Accumulated external imbalances financed via debt accumulation

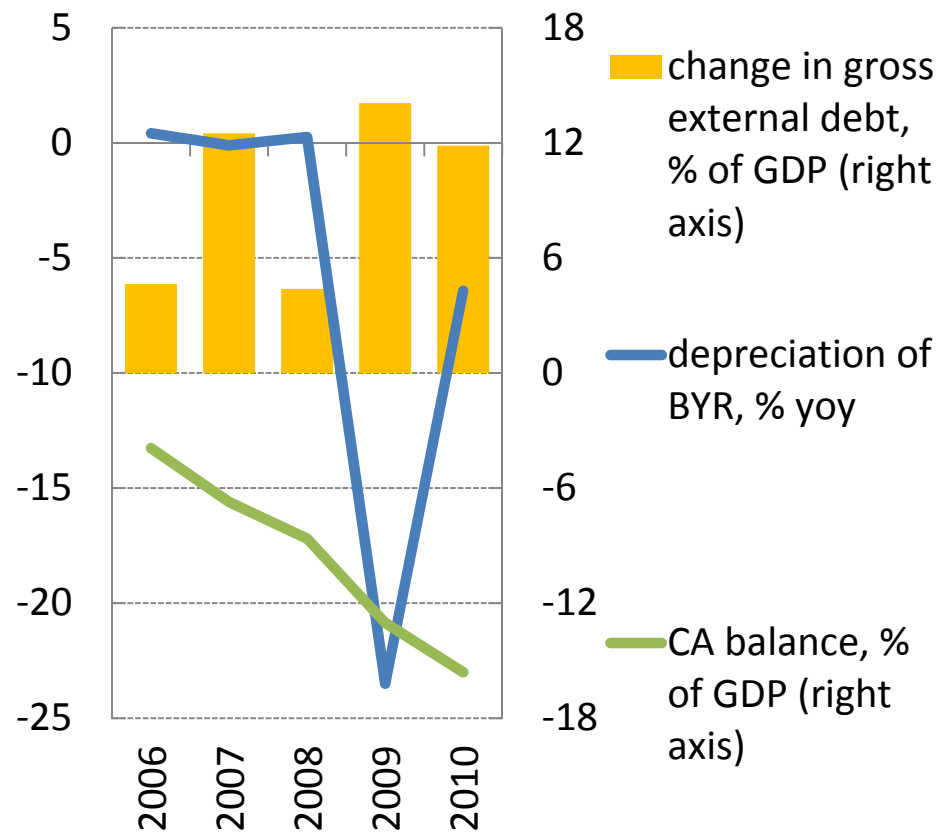


Source: own estimates based on the data from NBB, Belstat and IPM Research Center.

2009's policies did not remove external imbalances



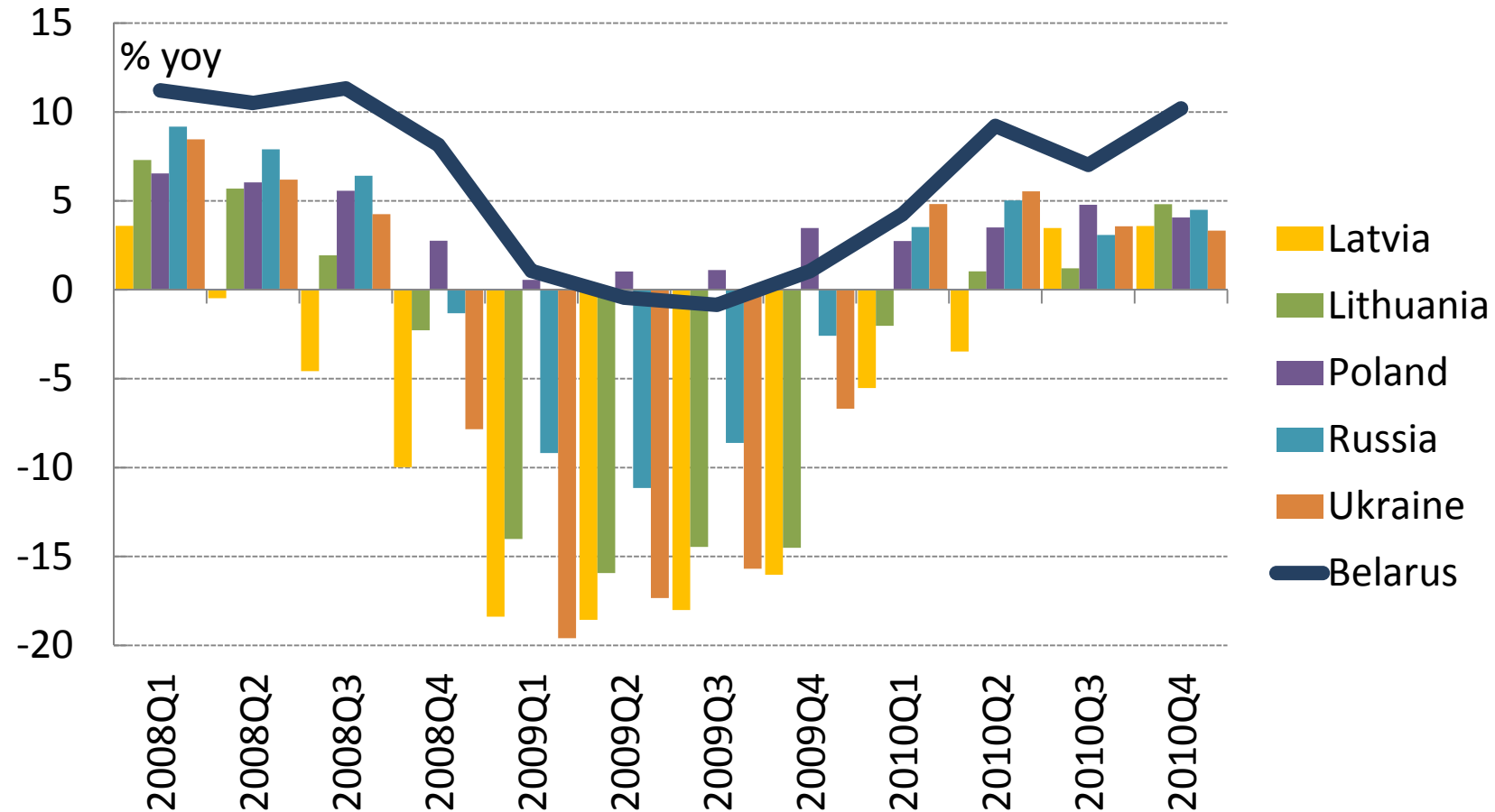
1998



2009

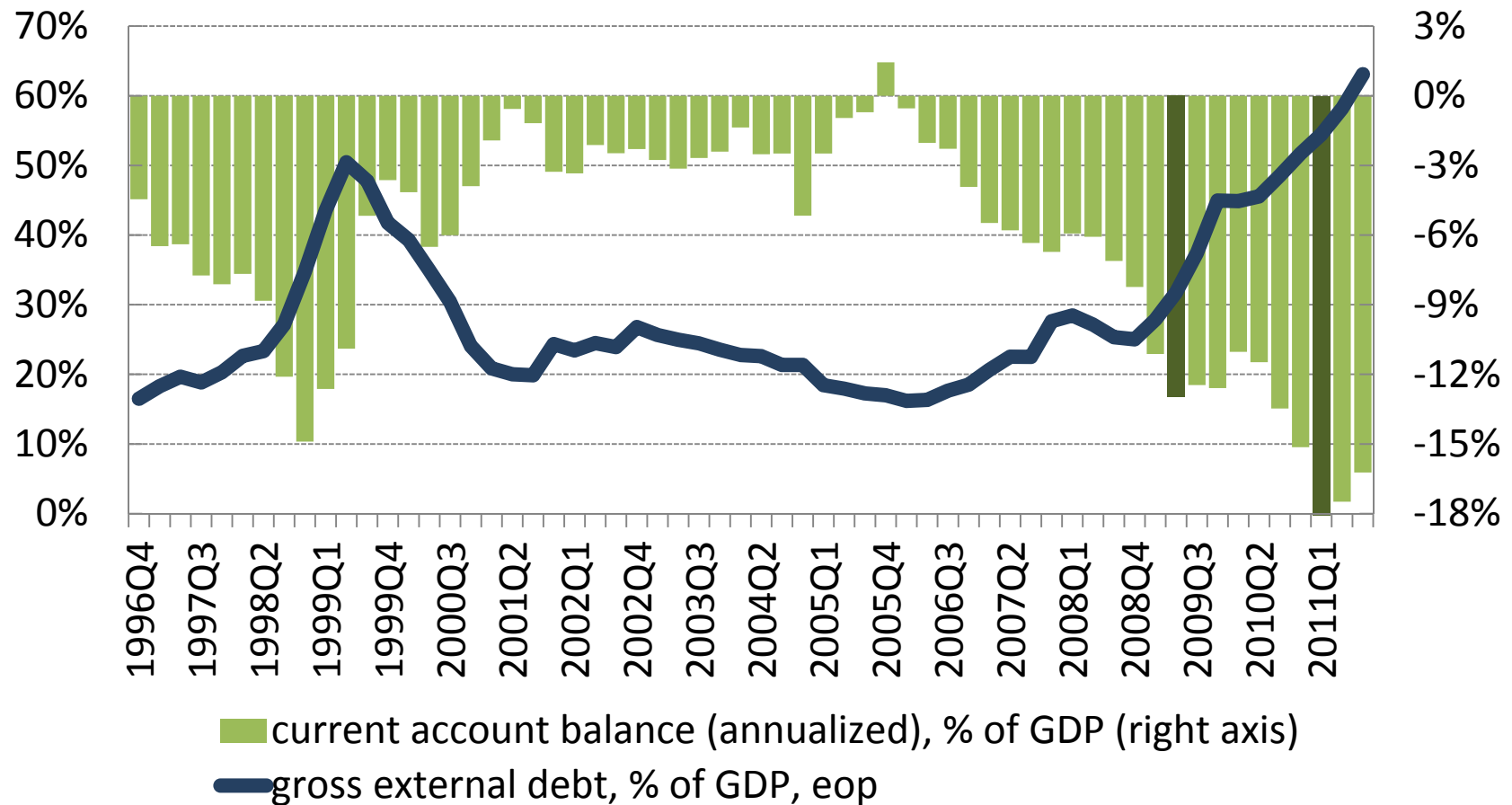
Source: own estimates based on the data from NBB, Belstat and IPM Research Center.

Smaller adaptation, faster (recovery)



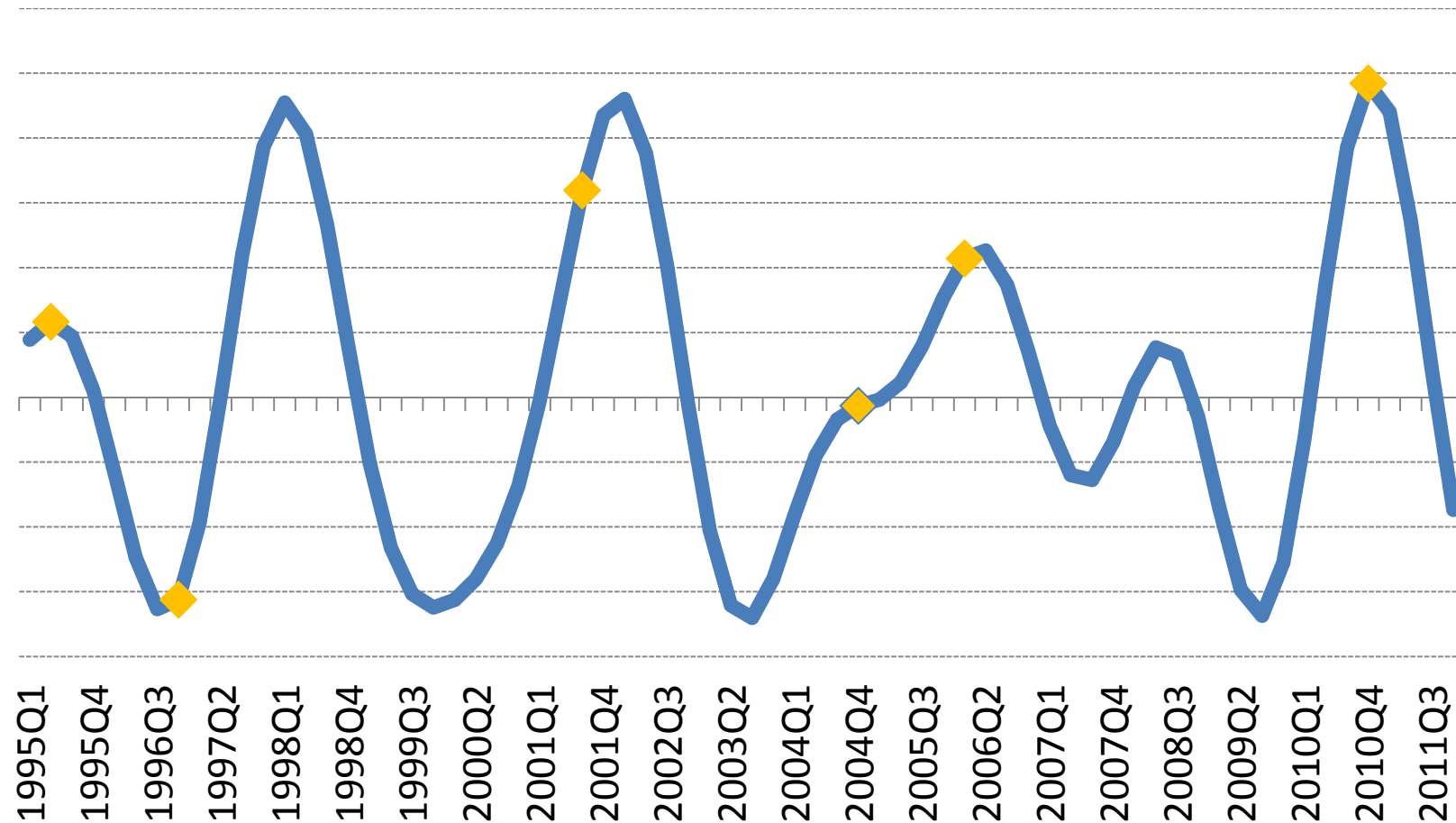
Source: IFS, local statistical authorities.

Accumulation of external imbalances continued



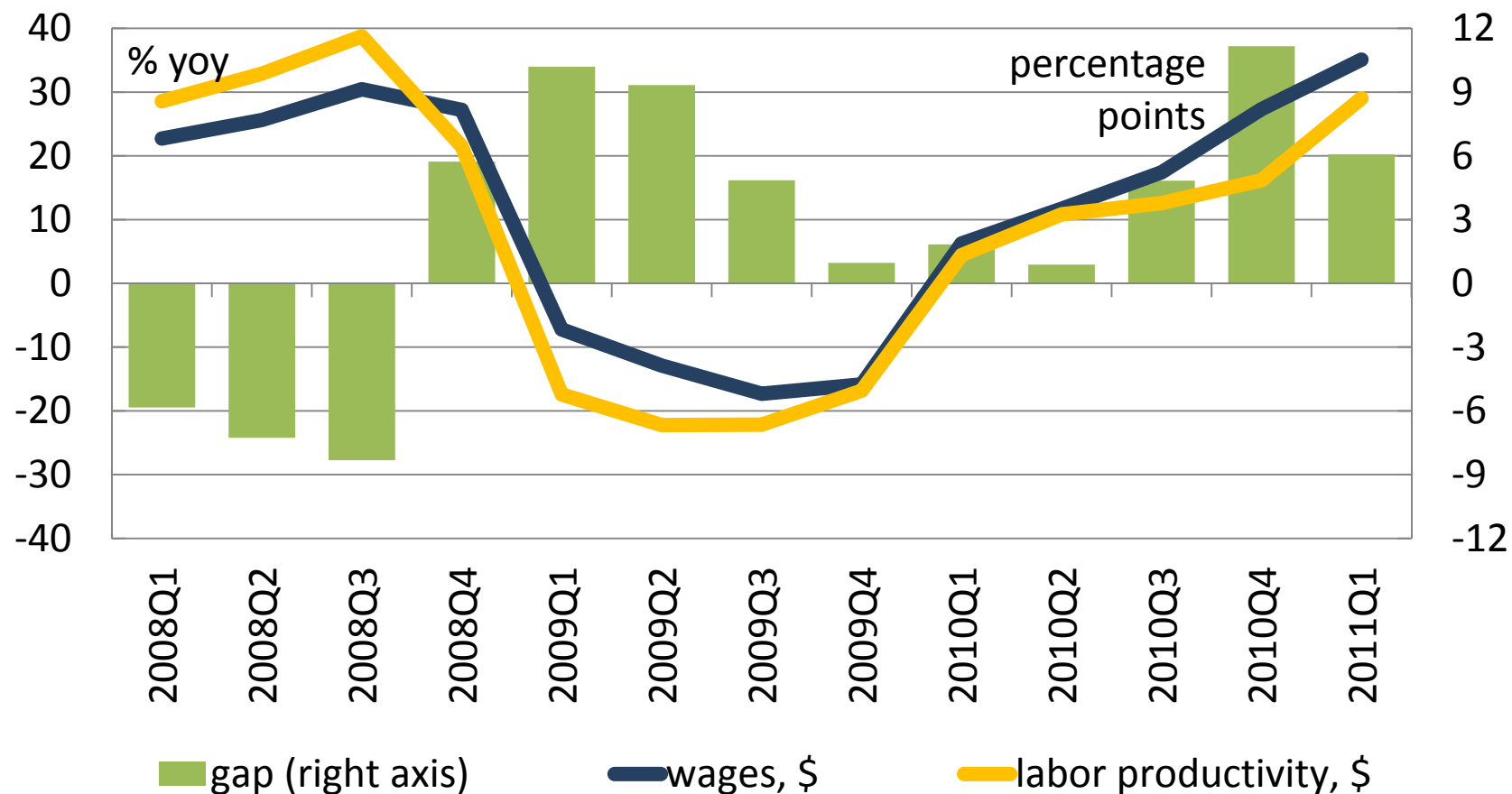
Source: own estimates based on the data from NBB, Belstat and IPM Research Center.

Political business cycle (cyclical component of real wages)



Source: own estimates based on Belstat data.

Gap between growth rate of wages and labor productivity

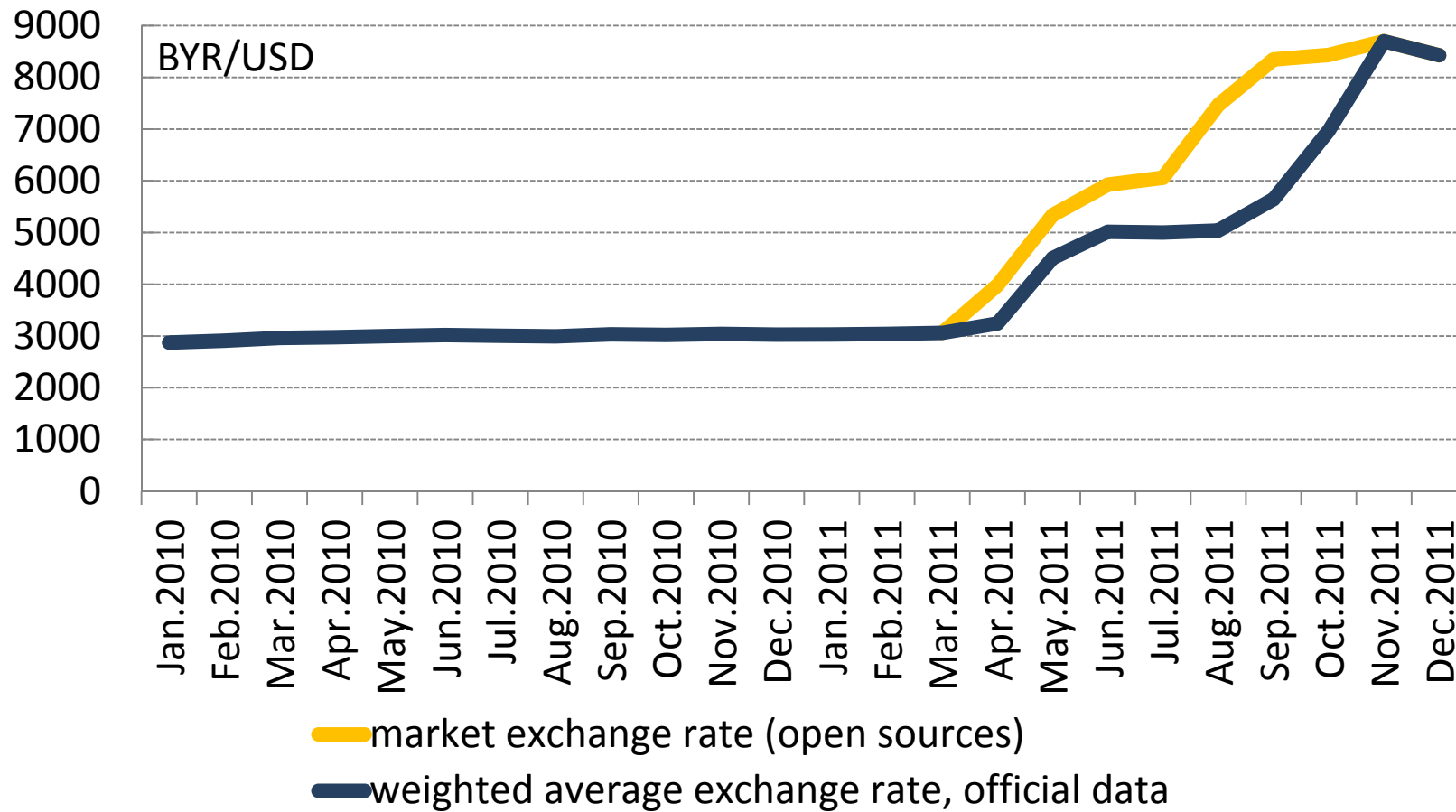


Source: own estimates based on the data from NBB, Belstat and IPM Research Center.

Determinants of the crisis-2011: brief conclusions

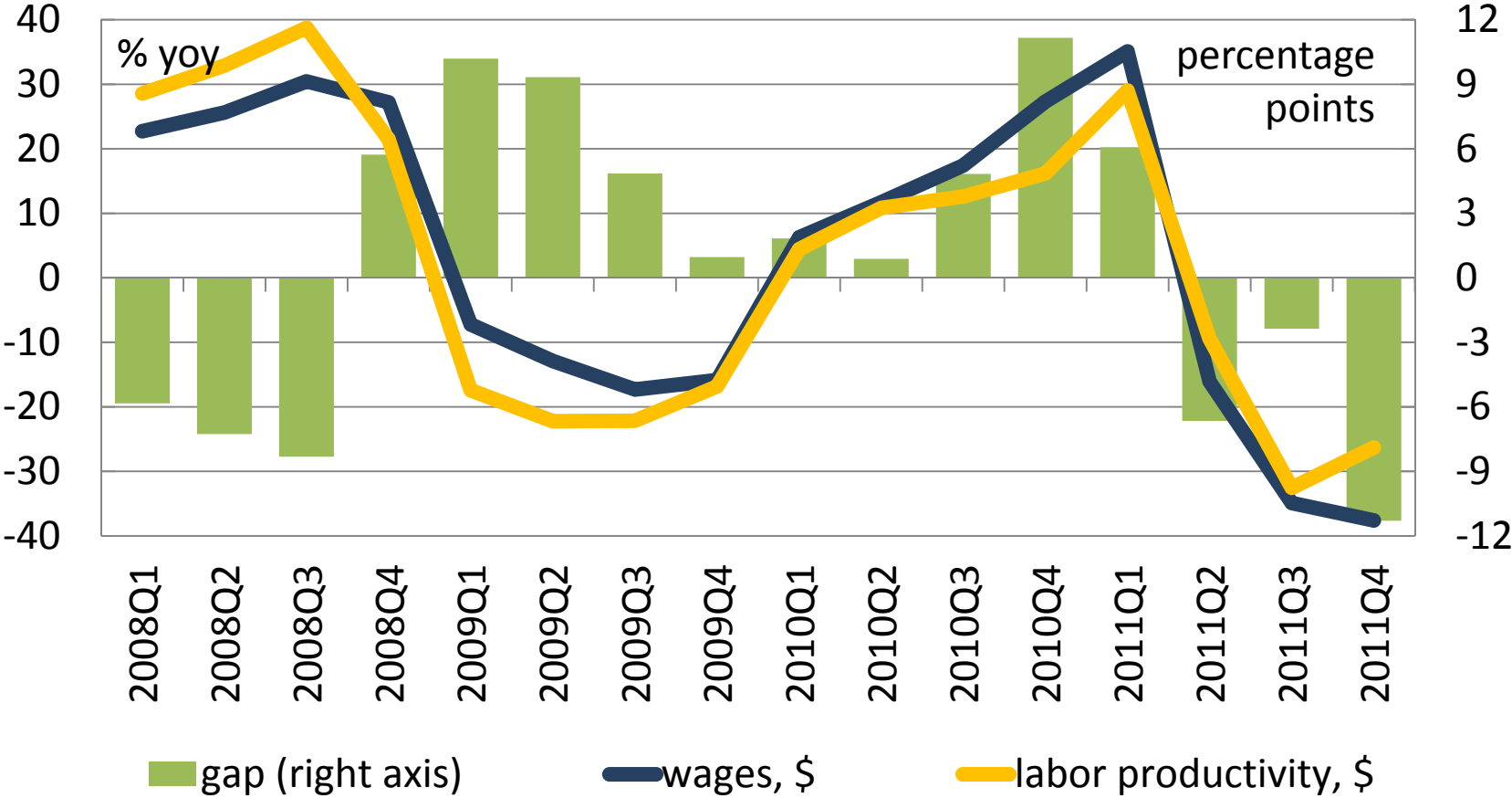
- Since 2007, the economy had been growing thanks to domestic demand growth, while exports grew much slower;
- This led to growing current account deficit and made this growth unstable;
- Economic heating before the elections-2010 aggravated structural imbalances, while new sources of their financing had become limited.

Depreciation and then devaluation were the main consequence of the crisis



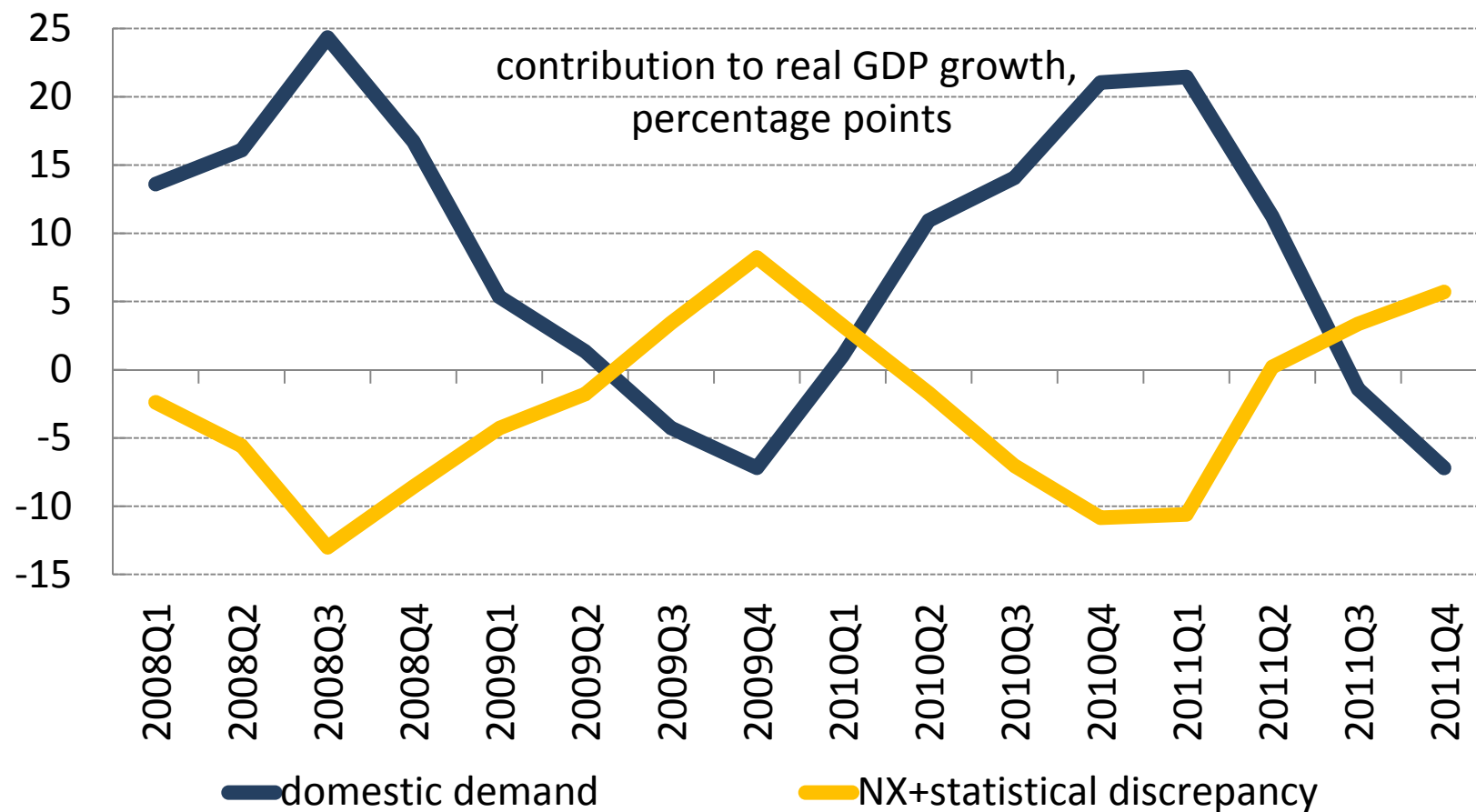
Source: NBB and IPM Research Center (based on the data from open sources).

Wages corrections were significant



Source: own estimates based on the data from NBB, Belstat and IPM Research Center.

Domestic and external demand went in opposite directions again



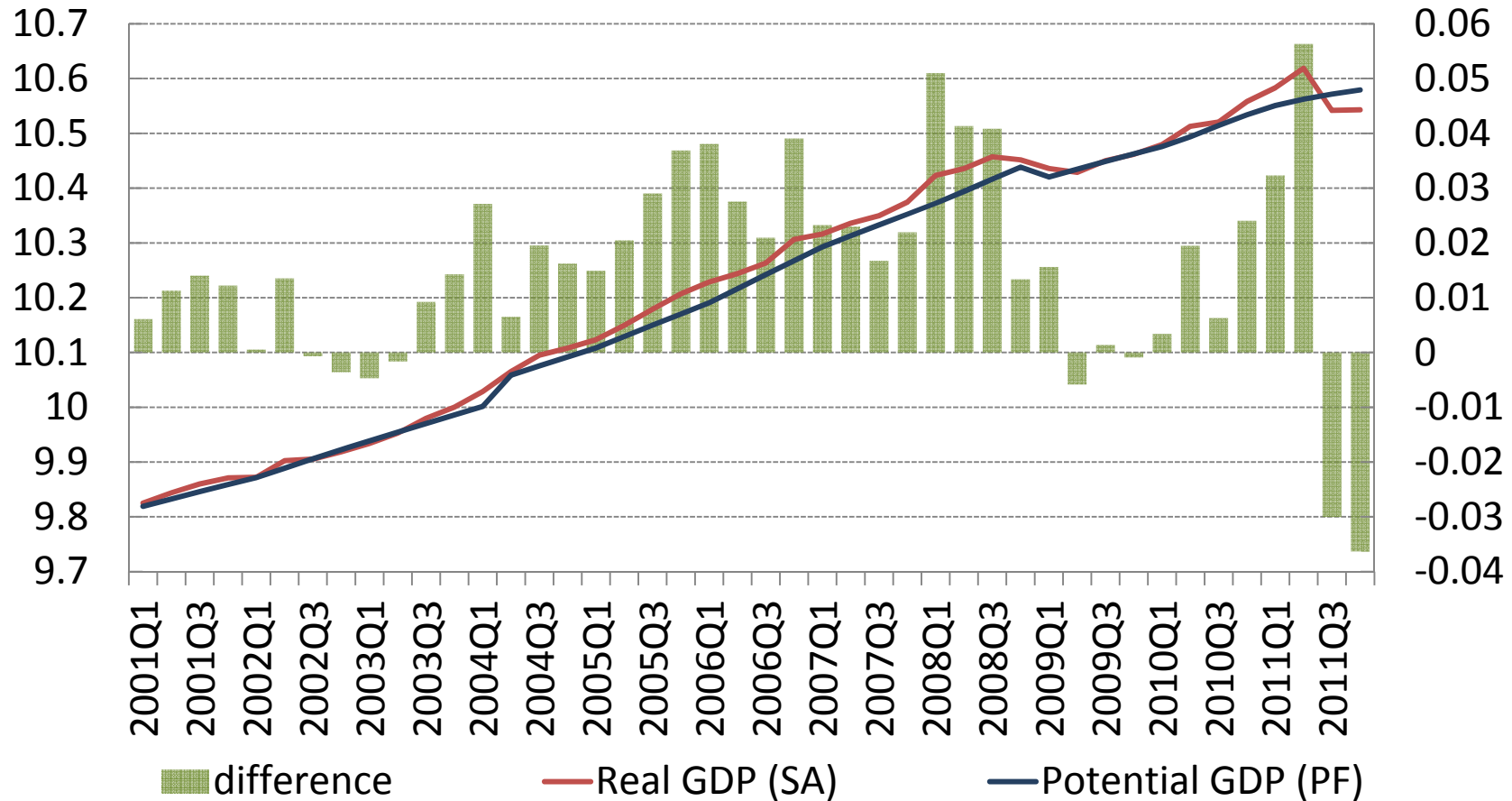
Source: own estimates based on Belstat data.

But the whole story of 2011 was not the same as in 2009

	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4 (e)
Real GDP	1.1	-0.4	-0.8	1.0	10.8	11.4	1.9	-1.5
Household consumption	2.8	-0.5	-1.6	0.1	10.3	4.8	-0.4	-8.7
Gross fixed capital formation	4.6	4.8	2.6	-6.3	7.6	9.8	-1.3	1.7
Other domestic demand	-2.0	-2.9	-5.3	-1.0	3.5	-3.3	0.3	-0.2
Exports (+1/2 S.D.)	-24.9	-22.2	-10.6	3.5	12.3	16.7	11.6	9.0
Imports (+1/2 S.D.)	20.7	20.4	14.0	4.7	-22.9	-16.5	-8.2	-3.3

Source: own estimates based on Belstat data (in constant 2009 prices); 2011Q4 – preliminary estimate by the IPM Research Center.

Growing above potential? Not for a long time...



Source: own estimates based on Belstat data.

Brief conclusions: what has happened with pre-crisis imbalances?

- Correction of the labor market imbalances (wages is now in line with productivity);
- Lower external imbalances: current account deficit in 2011Q3 is unusually low: 4% of GDP.

However, the fundamental determinants of these imbalances persist

- **No major reforms have been implemented: problems of inefficient sectors were “solved” via additional external borrowing (again) and lower gas prices.** But as soon as in the end-2012 and onwards Belarus should pay big share of its external debt back, while even at the new gas prices cost recovery in the utilities sector is extremely low (in case of households, only 17% of costs were covered by tariffs);
- Authorities insist on the necessity to increase wages to pre-crisis level (in a short period of time, from 1 to 1.5 years);
- In 2009, Belarus has similar “success story” when current account deficit fell to 5% of GDP in 2009Q3, but as soon as in the 2010Q4 it exceeded 20% of GDP.

Scenario 1: short-term growth that cost (at least) medium-term stability

- Wage increase via non-emission sources (via “administrative resource”, as before 2001 elections);

if no wage arrears/unpaid leaves:

- Recovery of domestic demand and lowering competitiveness (due to growing labor costs);
- Growing external imbalances (slower exports and faster imports growth) that (together with existing pressures) require the new borrowing or other financing sources;
- Managed (devaluation) or spontaneous (depreciation) correction and the new recession.

wage arrears/unpaid leaves:

- Migration/unemployment, growing pressure on social protection system;
- Political pressure (on the threshold of the new electoral cycle);
- Higher likelihood of populist policies.

Scenario 2: one more overheating with the same inflation/devaluation story as in 2011

No nominal anchor for the NBB exist: neither exchange rate (managed float) nor inflation (no inflation targeting);

- In order to recover investment activity (and enhance growth), the NBB reduces interest rates and slightly increase money supply growth;
- It pushes domestic demand and GDP growth up, but within 1-2 quarters disequilibrium at the money market leads to inflation acceleration;
- Higher inflation leads to real exchange rate appreciation and growing external imbalances and imbalances at domestic forex market;
- Either NBB will sell reserve assets to support the exchange rate or devalue in order to preserve reserves, nominal currency depreciation looks unavoidable in the absence of the new sources of external imbalances financing.

Scenario 3: common sense wins, reform starts

Belarus still can look attractive for foreign investors;

In order to return on growth path, it is *logical* to launch a reform package aimed at private sector development:

- Liberalization of wage setting;
- Privatization (lay-offs allowed in a bigger extent than now);
- Lowering cross-subsidization of households and sectors (like agriculture);
- Other measures aimed at business climate improvement;
- Monetary policy aimed at bigger confidence to the NBB and national currency (for instance, switching to inflation targeting);

As a result, one can expect labor productivity growth and transition to sustainable growth path.

But the IMF has reduced its presence in Belarus, as no program has been proposed by the authorities yet.

Short-term outlook

	2011	2012 (f)		
		IMF (Sep. 2011)	IPM RC (Nov. 2011)	Official (Dec. 2011)
Real GDP growth	5.3	1.2	1.6	5–5.5
CPI, % yoy	53.2	35.5	72.7	--
CPI, % eop	108.7	20.0	25-30	19-22
CA balance, % of GDP*	-14.4	-9.9	-4.7	0.0

* 2011 – estimate.

Source: IPM Research Center (Belarus Macroeconomic Forecast, November 2011); IMF (WEO database, September 2011).

- Difficult (if possible) to select a baseline scenario for a medium-term forecast;
- All forecasts assume (relative) exchange rate stability;
- To make official forecast realistic, either serious reforms/investment are needed in 2012, or another crisis will happen in 2013.