Macroeconomic situation-2019: a typical year of stagnation

Dzmitry Kruk, August 2020

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Abstract

In 2019, the Belarusian authorities were trying to maintain an infirm balance between (1) the preservation of the economic model with a dominant role of state-run enterprises, (2) a comforting rate of output growth, and (3) macroeconomic and financial stability. No success was achieved, and one of the components had to be sacrificed. Price, external and fiscal stability remained. Output showed 1.2% growth. The outstripping rate of real income growth was ensured, which improved the situation in the social sector. However, all these measures factored in a decline in the corporate sector finances. In pursuit of a balance, the government relaxed budget constraints for the public sector. Private sector enterprises grabbed the opportunities opened by business environment improvements of the previous years, and made a significant contribution to output growth.

Introduction

After the relatively successful year 2018, the economic authorities were kind of euphoric. Official forecasts for 2019 presumed a noticeable acceleration in output growth to 4%, which was above the equilibrium growth estimates for Belarus (around 2.5%).

The government, probably, counted on a favorable external environment, hoping that systemic problems that hampered economic growth were resolved in previous years. Therefore, it relied on economic activity growth in 2019 primarily thanks to higher external demand that would revive domestic demand, first of all investment, which has still not recovered to the pre-recession level of 2014. Also, accelerated growth of capital investment was expected after the launch of the Belarusian nuclear power plant initially planned for late 2019.

Most of the hopes did not come true. The price terms for foreign trade worsened, and adverse events occurred in some global commodity markets that are essential for Belarus (potash fertilizers, mining trucks), which led to sagging demand for Belarusian goods.

Global trends affected Russian economic growth, which remained very modest, and resulted in a reduced demand for Belarusian goods and services. Furthermore, throughout 2019, Belarus was under Russian pressure on a whole range of economic issues. By the end of the year, this pressure resulted in a conflict over the terms of oil supply, which was an important factor affecting economic dynamics.

Contrary to expectations, the expected surge in investment in late 2019 did not revitalize economic activity. First, the commissioning of the NPP was postponed again to 2020. Second, as negative expectations heightened by the end of the year, companies curbed their investment appetites, and households scaled down housing construction

Proliferation of institutional contradictions

In 2019, the government's economic policy was conceptually based on the assumption that the most obvious institutional defects, such as the low efficiency of state-owned enterprises and their accumulated debt, were mitigated enough to ensure moderate growth of the economy. Therefore, significant institutional innovations seemed to be irrelevant, and the country's leadership focused on the consolidation of emerging trends.

The plan was to cut directed lending to BYN 800 million (this began in 2015, and the proportion of such loans declined to an insignificant amount by 2019), limit other kinds of direct and indirect support to state-owned enterprises, and switch from soft loans to subsidies (since 2018) in housing construction.

With regard to the private sector, the revocation of the decree on pseudo-entrepreneurship, which steamed up private business, was the most important event of the past year.

The strategy aimed at increasing confidence in the national currency was also significant for financial markets and financial stability. Several progressive regulations for budget administration, stock market development, accounting and prudential governing were introduced.

However, amid systemic problems in the public sector, the government de facto intensified the provision of direct budget support to state enterprises, and indirect support in the form of debt restructuring, payment of part of interest on loans, etc. The initially approved amount of directed lending (BYN 800 million) increased by BYN 184 million and the complete abolition of this lending planned for 2020 was postponed to 2021. Measures to support state enterprises were put to practice in 2019 under the landmark Orsha District Development Program.

This marked the curtailment of the policy of budget constraints for state-owned enterprises, since even half-hearted changes in 2016–2017 put in question the viability of business models for most of them. The government was no longer strongly determined to create a market of bad debts and establish new rules for banks to deal with troubled borrowers. A draft regulatory act aimed at responding to the chronic (since 2016) problem of bad debts had been worked on since 2017, and its adoption was planned for 2019. However, the draft got bogged down in bureaucratic approval procedures and was removed from the agenda before the end of the year.

No significant changes occurred in the functioning of the private sector. Many private companies managed to increase output and/or improve their financial performance after a fragmentary liberalization in 2016–2017. Nearly 80% of surveyed private small and medium businesses considered their standing in 2019 as satisfactory or good with stable or moderate positive dynamics. The IT sector, primarily the High Technology Park (HTP), showed a fairly rapid development. IT service exports grew by 30% to USD 2.4 billion, and the share of the information and communications sector in GDP reached 6.2% largely thanks to privileges granted by the 2017 decree on digital economy development.

The inertia of a catch-up growth fade away, output growth weakened and became uneven

Institutionally, the economy remained conserved, and the weakness of the GDP growth potential remained a problem as in previous years. In 2019, the equilibrium growth potential was estimated at 1.5% to 3%, but the capacity for achieving even these figures was doubtful, not to mention the overly optimistic official target of 4%.

Firstly, the recovery growth effect was virtually over in the beginning of 2019, largely because the GDP growth rate in 2017–2018 had been slightly in excess of the growth capacity. Secondly, during that time, the economy was at a cyclical growth retardation stage due to the faded out recovery effect and the deterioration of the external environment. Thirdly, the economy was influenced by local shocks that led to multidirectional output jumps. For instance, a positive shock of consumer sentiment spurred output growth early that year, and then it slowed down due to the contaminated oil incident and heightened disagreements in talks with Russia in the second and fourth quarters. As a result, the year 2019 was distinctively marked by the arrhythmic economic activity in the relatively favorable first and third quarters and unfavorable second and fourth quarters. Business cycle disturbances affected the macroeconomic performance, leading to increasing uncertainty and fettered economic activity of companies and households.

GDP showed a modest 1.2% growth in 2019, which is below the official forecast and the actual indicators of the previous two years. In terms of demand, domestic demand components (household consumption and gross capital formation) contributed to output growth the most, while the contribution of net exports turned out to be negative. Growth of imports that outstripped exports was a matter of concern, but its scale was not alarming. With the accumulated safety margin, a foreign trade surplus decline did not pose a threat to external equilibrium.

In terms of supply, the largest contribution to output growth was made by the ICT sector, production sector (mainly vehicles and equipment manufacture, metallurgy and wood processing), agriculture and construction.

Macroeconomic and financial stability have been maintained, but there are still risks of loosing them

Like in the previous years, in an attempt to accelerate growth and ensure macro and financial stability the authorities still prioritized the latter. Therefore, they used monetary and fiscal policy tools very carefully.

The influence of monetary and fiscal policies on the output dynamics was close to neutral throughout the year, despite some spikes and variations of the channels of this influence. Directions of fiscal impulses related to consumer and investment demand were changing. A side effect on the monetary environment was produced by a new macro-prudential tool introduced by the National Bank–estimated standard risk rates. ESRR-based prudential penalties for high interest rates pushed banks toward redirection of loan offers from the consumer segment (which caused a slowdown in its rapid growth) to the corporate one.

Restrained economic policy kept the values of indicators that characterized macro-stability in a safe range. Despite a considerable acceleration early in the year, inflation remained close to the 5% target. Cumulative inflation was at 4.7%; average annual at 5.6%. The current account of the balance of payments worsened slightly to 1.8% of GDP in 2019 from 0.04% in 2018, but remained in the range that can be considered equilibrium for Belarus. The consolidated budget still had a surplus of 2.4% of GDP, which was primarily used to pay off the public debt.

Trends were more controversial in the field of financial stability. On the one hand, liquidity in foreign exchange significantly improved, largely thanks to increased FX net supply on the domestic market. Households showed a year-on-year decrease in this segment (USD 0.6 billion against USD 1.1 billion), while legal entities sharply increased the net supply (USD 1.1 billion, net demand standing at USD 0.2 billion in 2018). This made it possible to increase the country's gold and foreign exchange reserves by USD 2.2 billion to USD 9.4 billion, and their quality improved.

A decrease in the public debt burden against the backdrop of GDP growth and a slight increase in the absolute size of the public debt was also a positive trend. A part of new state borrowings was denominated in Russian rubles (equivalent of USD 0.15 billion). The susceptibility of the debt to the exchange rate decreased insignificantly, but it became obvious that the authorities realized the problem. The placement of Eurobonds in Belarusian rubles worth around USD 100 million by the Development Bank of the Republic of Belarus was even more symbolic in this regard.

On the other hand, poor financial performance of companies, primarily state-owned, affected the quality of corporate debts. Government support measures remedied the situation just a little. Therefore, banks remained relatively passive in lending. The year also saw a decrease in banks' profitability indicators.

As economic growth slowed down closer to the end of the year, and disputes with Russia grew bitter, many of the conserved contradictions manifested themselves again. Authorities' declarations and some actions they took (intensification of unconventional forms of support for state-owned enterprises) cast doubt on the justification of the adherence to the macroeconomic stability goals amid low growth and accumulated threats to financial stability.

Real disposable income grew, the distortions in income distribution weakened

Along with the adherence to the macro-stability goals, the government tried to bolster growth impulses by increasing wages and social benefits through three channels: first, by means of direct fiscal incentives, i.e. growth of nominal wages in the public sector and budget transfers; second, by means of direct influence on the dynamics of wages at state-owned enterprises; third, by giving an impetus to wage growth in the public sector and at state-owned enterprises. As a result, wages and pensions (in real terms) grew at a faster pace (relative to labor productivity and output growth), which, at the end of the year, were at 7.7% and 13.1%, respectively.

Accelerated growth of wages, however, produced a negative effect on future macro- and financial stability, in particular, the financial standing of enterprises, where labor costs grew at a faster pace. Accelerated growth of consumer demand deteriorated the current account balance of the balance of payments.

This, of course, favorably affected the social sector. Real wages and pensions reached all-time highs. Furthermore, the authorities managed to maintain a relatively favorable labor market environment, which slightly worsened in the last months of the year. Unemployment decreased from 4.6% early in the year to 4.0% by the end of the year, while the employment rate remained virtually unchanged. Secondly, the government almost completely eliminated the imbalances in the distribution of revenues. The ratio of the real size of the average pension and wage approached the desired level of 40%, and the poverty rate was down to a historic low (around 3.5% by the end of the year).

Tensions with Russia and new threats

The economic situation rapidly changed in the fourth quarter of 2019. Surveys showed that commercial entities and households had negative expectations. Companies postponed or even curtailed investment projects. Demand in the labor market decreased at the end of the year. The number of new jobs sharply decreased, and the unemployment rate went up, albeit slightly (from 3.9% to 4.0%) for the first time since 2017 mainly due to adverse developments and uncertainty caused by heated oil and gas disputes with Russia.

Twists and turns of Belarus-Russia negotiations on “greater integration” and oil and gas supplies revealed conceptual contradictions between the countries. Belarus strongly counted on facilitated access to the Russian market, low gas prices, and preferences in trade in oil and oil products, believing that its membership in the Eurasian Economic Union guaranteed all this.

Russia’s commitment to implement the tax maneuver in its oil sector to the detriment of the financial interests of Belarus was a short-term challenge for macro- and financial stability in 2020. From this perspective, acceptance of Russia’s terms would mean an increase in the purchase price of crude oil to around 83% of the world price (up 4 percentage points against 2019), which would nearly reduce the profitability of the Belarusian refineries to zero, and result in a drop of fiscal revenues and foreign trade receipts by USD 250 million.

More importantly, the Russian tax maneuver was a strategic threat to the justifiability of the Belarusian economic model, in which oil refinery is one of the drivers of the national economy. Acceptance of Russia’s terms from 2020 (the start of subsidies for Russian refineries) would de facto mean acceptance of Russia’s interpretation of EEU agreements and inability to cite them as a justification of the claims for favorable terms in trade in energy commodities.

Belarus is hardly able to ensure the cost-effective functioning of its oil refining industry by means of compensatory measures aimed at mitigating tax maneuver impacts. Therefore, at the end of 2019, the Belarusian government took a tough stance in negotiations with Russia in an attempt to preserve the convenient economic model, which faces a medium-term threat.

Conclusion

The year 2019 was quite indicative, as it displayed the state of the national economy, its prospects and problems. On the one hand, disciplined economic policy made it possible to maintain macro-stability, low inflation and close-to-equilibrium balance of payments and fiscal position.

On the other hand, output growth was insignificant and unsatisfactory against the backdrop of a wide range of institutional defects. Trying to raise household incomes and improve the situation in the social sector, the authorities resort to measures that adversely affect the financial situation in the corporate sector. This, in turn, forces them to intensify the use of public sector support tools and curtail the previously proclaimed policy of tightening budget constraints.

As a result, the Belarusian economy faced a trilemma in 2019: it is hard to simultaneously maintain:

- the economic model with the dominant role of state-owned enterprises
- a comforting output growth rate
- macroeconomic and financial stability

Throughout the year, the government tried to sacrifice little bits of each component. However, new challenges emerged at the end of the year due to disagreements with Russia. Under deteriorating external conditions, it will be more and more difficult to maintain a fragile balance between the three components above.