



BELARUS

Highlights

- **The authorities have implemented a number of structural reforms.** Recent measures include improved cost recovery of utilities, the gradual wind-down of directed lending, the abolition of price controls on socially important goods and services, the phasing out of volume targets for state-owned enterprises (SOEs), and improved links between wages growth and productivity.
- **The economy remains in recession.** After a 3.9 per cent contraction in 2015, GDP fell by 2.9 per cent year-on-year in the first nine months of 2016. Strong economic linkages with Russia through trade, investment and financial flows are exposing the Belarusian economy to headwinds due to the economic difficulties in Russia.
- **Despite improvement, significant macroeconomic imbalances remain.** A more flexible exchange rate regime and tight monetary, fiscal and credit policies have helped to halt the drain of foreign exchange reserves and put inflation on a downward trajectory. The current account deficit declined significantly in 2015. However, dependence on external funding support remains significant given the low level of foreign exchange reserves.

Key priorities for 2017

- **Deeper structural reforms are needed to increase the private sector's role in the economy.** Administrative controls and distorting regulations should be further relaxed to create a more conducive environment for private sector development. Commercialisation and privatisation of SOEs should be a priority. To enhance resource allocation efficiency, credible and timely steps should be taken to deliver on the objectives of the recently adopted 2016-2020 Government Action Plan.
- **The authorities should persist with economic stabilisation policies.** Maintaining reasonably tight fiscal and monetary policies and exchange rate flexibility will be important for reinforcing macroeconomic stability. Conservative fiscal planning is especially important given the significant contingent liabilities from quasi-fiscal activities in the real and financial sectors and sizeable public debt service obligations.
- **The stability and market-orientation of the financial sector need to be enhanced.** State-owned banks should increase the share of market-based lending, while directed lending should continue to be phased out. Financial sector oversight would benefit from more independent, risk-based supervision.

Main macroeconomic indicators %

	2012	2013	2014	2015	2016 proj.
GDP growth	1.7	1.0	1.7	-3.9	-3.0
Inflation (average)	59.2	18.3	18.1	13.5	12.7
Government balance*/GDP	0.7	0.1	0.7	1.9	-1.9
Current account balance/GDP	-2.9	-10.4	-6.9	-3.7	-4.9
Net FDI/GDP [neg. sign = inflows]	-2.1	-2.7	-2.4	-2.8	-3.0
External debt/GDP	53.2	54.4	52.8	69.6	n.a.
Gross reserves/GDP	12.7	9.1	6.6	7.6	n.a.
Credit to private sector/GDP	20.7	21.0	21.8	23.9	n.a.

* NOTE: Includes central government, local government and social security funds.

Macroeconomic performance

Belarus's economy contracted in 2015, after 19 consecutive years of positive growth.

GDP fell by 3.9 per cent year-on-year in 2015, driven by a significant real contraction in all major sectors including: mining (-7.8 per cent year-on-year), manufacturing (-6.1 per cent year-on-year), construction (-9.5 per cent year-on-year), and agriculture (-3.5 per cent year-on-year). The recession continued in 2016: GDP contracted by 2.9 per cent year-on-year in the first nine months of the year. Manufacturing, the largest sector of the economy, fell by 1.5 per cent year-on-year in the first nine months of 2016 and construction output decreased by 16.8 per cent year-on-year. In the same period, the agriculture, mining and logistics sectors posted small positive growth. In 2015, real wages contracted by 2.3 per cent year-on-year for the first time since 1995. Consumer price inflation slowed from 18.1 per cent in 2014 to 13.5 per cent in 2015 and further to 12.1 per cent in the first nine months of 2016, amid moderation of wages and generally tight fiscal and monetary policies. From the second quarter of 2016, the National Bank of Belarus (NBB) started to ease monetary policy. The refinancing rate was reduced from 25 per cent to 18 per cent between April and August 2016. The general government balance was in surplus of 1.9 per cent of GDP in 2015 and an estimated 2.5 per cent of GDP in the first eight months of 2016, with the surpluses earmarked for repayment of foreign exchange liabilities and payment under the government's guarantees to banks. The public debt-to-GDP ratio increased from approximately 37 per cent in 2014 to approximately 54 per cent in 2015.

The authorities have made progress in addressing external imbalances although weaknesses remain.

The current account deficit declined from 6.9 per cent of GDP in 2014 to 3.8 per cent of GDP in 2015 supported by devaluation and a more flexible exchange rate regime. In 2015, the Belarusian rouble depreciated against the US dollar by 36 per cent, with a knock-on effect on the real and financial sector balance sheets. In the first quarter of 2016, it depreciated by a further 8 per cent and remained stable in the second and third quarters of the year. Against the backdrop of depreciating currency, loan dollarisation increased from 52.3 to 58.1 per cent and liability dollarisation from 63.3 to 74.1 per cent in 2015. The ratio of gross external debt to GDP increased from 52.8 per cent in 2014 to 76.7 per cent in the first half of 2016. The NBB reported a ratio of non-performing loans (NPLs) to total gross loans of 13.4 per cent as of the end of the first half of 2016. However, the underlying weakness may be more pronounced as a number of problem loans have been swapped for government securities, and NPL monitoring is difficult due to directed and subsidised lending programmes, which continue to be a tool of the government's economic policy. Foreign currency reserves declined from US\$ 3.9 billion in November 2014 to US\$ 2.4 billion in September 2016, providing just one month of imports coverage.

The short-term outlook depends on the extent of Belarus's internal adjustments, as well as regional factors. The GDP contraction in the first nine months of 2016, tight economic policies and reduced demand for exports due to the recession in Russia all point to challenging growth prospects in the near term. The economy is expected to contract by 3.0 per cent in 2016; to be followed by a slow projected recovery of 1.0 per cent in 2017.

Major structural reform developments

Comprehensive structural reforms, which were delayed when the economy was growing, are back on the agenda. The limitations of the existing growth model are becoming increasingly apparent for the authorities, although the will and the ability to implement a far-reaching reform agenda in the context of the economic recession are unclear. In January 2016, the authorities abolished price controls on socially important goods and services and eliminated volume output targets for SOEs. Basic household tariffs for water supply and wastewater treatment were increased by 85 per cent. Electricity tariffs were also increased by 20 per cent by eliminating the VAT exemption for households. Although the authorities only partially increased heating tariffs over the winter months (by more than 30 per cent), they aim to eliminate subsidisation. The authorities plan to advance closer to full cost recovery for utilities by the end of 2018. The privatisation process remains stalled, although the authorities have indicated an interest in relaunching it. Directed and subsidised lending by banks has declined, with plans of fully phasing out such credits by 2019. The mandatory sale of foreign exchange from export receipts was further lowered from 30 to 20 per cent of revenue, effective from 1 September 2016.

In the World Bank's *Doing Business 2017* report, Belarus ranks 37th out of 190 economies, with low scores in getting credit, paying taxes and resolving insolvency.

A comprehensive government action plan has been adopted. In April 2016, the authorities adopted the new programme of social and economic objectives, known as the 2016-2020 Government Action Plan. The programme focuses on increasing the flexibility of the economy and on achieving better efficiency of resource allocation. The priority measures under the action plan include improvements in the business environment, promotion of competition, commercialisation of lending to the economy, restructuring of SOEs, optimisation of the energy sector and utilities, and other important steps to steer the economy towards market principles.

The authorities are pursuing financial support from several international sources. In March 2016, the Eurasian Fund for Stabilization and Development (EFSD) approved a US\$ 2 billion loan for Belarus, to be disbursed in seven tranches during 2016-18. The first and second tranches for US\$ 0.8 billion were disbursed in March and July 2016. The EFSD's matrix of economic policy and structural reform measures envisages disbursement conditionalities in the following areas: (i) macroeconomic stabilisation, (ii) reduction of government support of the goods and services markets, (iii) commercialisation and privatisation of state enterprises and increased social protection, and (iv) improvement of the business climate and development of the private sector. The Belarusian authorities have also been in discussions with the International Monetary Fund (IMF) about a possible lending programme.

Pension reform has advanced, targeting improved fiscal sustainability. According to a presidential decree issued in April 2016, the pension age will be incrementally increased starting from 1 January 2017: for men it will be increased from 60 to 63, and for women from 55 to 58. The increase will occur over six years, with six months added to the retirement age every year. The decree also encourages employers and employees to engage in additional voluntary saving schemes for a better retirement income.