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# Research Report on Belarus

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## Introduction

The low creditworthiness of Belarus remains rooted on its vulnerabilities to external shocks and the effects of high involvement of the government in the economy. Government-led wage increases and price controls have led to distortions and imbalances in recent years. Lately, directed lending and inconsistent monetary and exchange rate policies emerged as main internal risks for Belarus.

Russia remains the major trade partner of Belarus, as well as its main source of external shocks. Additionally, participation in the Eurasian Economic Union[1] (EEU) is unlikely to further improve Belarussian trade with other members of the organization if current conditions prevail. Government debt load, as well as fiscal balance, remain sound and present limited risk for the country in the short- and mid-term.

**Main Economic Indicators of Belarus**

| Macro indicators | 2012 | 2013 | 2014 |
| --- | --- | --- | --- |
| Gross pub. debt, bill BYR | 203986 | 243843 | 309825 |
| Nominal GDP, bill BYR | 530356 | 649000 | 778456 |
| Real GDP growth, % | 1,73 | 0,89 | 0,94* |
| Gross gov. debt/GDP,% | 38,5 | 37,6 | 39,8 |
| Deficit (surplus)/GDP,% | 1,7 | -0,9 | 0,4 |
| Inflation rate,% | 21,8 | 16,5 | 16,2 |
| Curr. Account balance/GDP,% | 0,0 | -5,2 | -0,8 |

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

| Default indicator | As of 08.09.2015 |
| --- | --- |
| 7Y Gov Bond Yield, % | 9,64 |

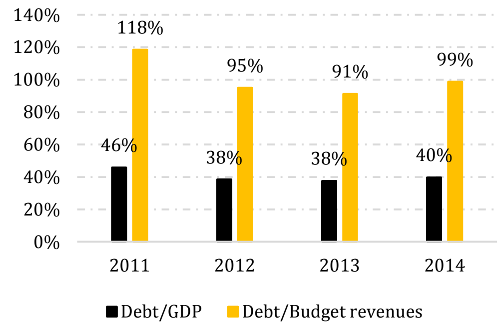
Sources: RAEX (Europe) calculations based on data from IMF, UN, Deutsche Börse. *IMF Forecast

**Debt resumes growth, but remains low.** In 2014, debt ratios returned to the negative trend reversing the improvements they had shown during the period 2011-2013 (see graph 1). This was driven by a 27% increase of gross government debt to 309,8 Trillion BYR in 2014 from 243,8 Trillion BYR in 2013. Additionally, a slowdown of nominal GDP and budget revenue growth rates contributed to the worsening of debt ratios. Long-term exposure remains high as reflected by the yield on 7-year sovereign Eurobonds at 9,64% p.a. as of September, 8th 2015.

**Fiscal balance remains influenced by quasi-fiscal operations.** According to preliminary data provided by the IMF, the Belarusian government ended 2014 with a positive fiscal balance at 0,4% of GDP. This represents an improvement from 2013, when the balance was negative 0,9% of GDP. The 2014 result was driven by a more prudent fiscal policy of cutting government expenditures by a higher rate than the drop in revenues. Furthermore, the reduction of quasi-fiscal operations, such as directed and subsidized lending programmes, contributed to the fiscal surplus of 2014. Under the government's "financing plan", a temporary instrument to prioritize government funded projects in the face of financing constraints, the volume of new directed lending declined to about 4% of GDP in 2014 from 5% of GDP in 2013.

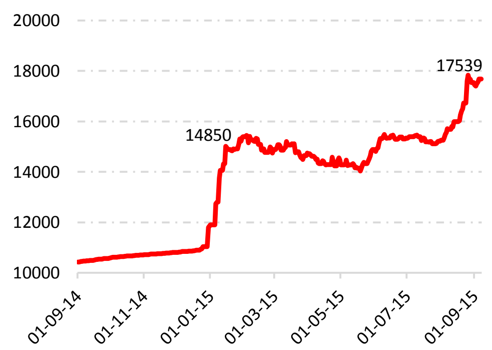
[1] The Eurasian Economic Union (EEU) comprises Belarus, Russia, Kazakhstan, and Armenia and will soon also include Kyrgyz Republic. The EEU guarantees the free transit of goods, services, capital, and labor and envisages a coordinated policy for key economic sectors.

**Graph 1: Gross government debt**




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

**Graph 2:** Exchange rate, USD vs. BYR




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

**Evolving monetary and exchange rate policies.** Following the January devaluation of the BYR (see graph 2), the National Bank of the Republic of Belarus (NBRB) changed its crawling peg regime against the USD for an exchange rate policy based on a currency basket comprising RUB, USD and EUR. However, more time is needed to assess the efficiency of the new currency regime.

Monetary policy has been prone to external factors leading to policy inconsistencies. In 2014, the NBRB gradually lowered its refinancing rate (see graph 3) to reduce the cost of credit, while using quantitative controls to slow-down credit growth. In January 2015, the NBRB increased the refinancing rate sharply to 25% in order to contain inflationary pressures triggered by BYR devaluation, which in turn was the response to the spillover effect of the economic crisis in Russia. However these moves decimated the earlier efforts of the NBRB to reduce the cost of credit and stimulate the economy.

**Inflation declined but upside risks remain.** As mentioned in our previous research report[2], Belarusian authorities decided to match the real wages growth rate with the real GDP growth rate in an attempt to bring real wages closer to productivity levels. Thus, real wages grew 0,3% in 2014 as compared to 16,4% in 2013, while in Q1 2015 real wages declined by 3,1% against Q1 2014.

Slowdown in growth of real wages, alongside price controls imposed on a number of "socially important goods"[3], were the main factors that reduced inflation during 2012-2014 (see graph 4). These government moves have brought the inflation in 2014 down to 16% from the 2011 hyperinflation at 109%.

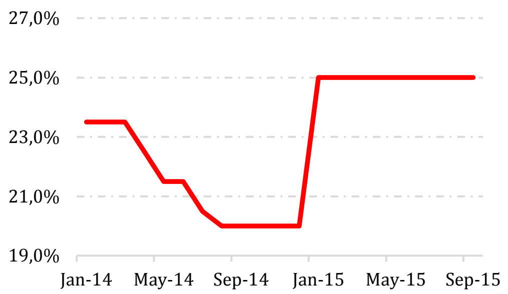
However, we expect that the January 2015 devaluation of the BYR will again be a major factor of inflation rise, as was the case in 2011. Devaluation and downsizing the share of "socially important goods" in the CPI basket, will push inflation to around 22% by the end of 2015.

**Dependence on external financing still strong.** Belarus' dependence on international financing remains strong and will play a major role in October 2015 presidential elections. As part of a move to achieve economic tranquility before elections, the government has ensured financing from partner-countries (mainly Russia). Even though Russia has suffered economic difficulties since early 2014, its aid to Belarus has remained strong.

[2] Research Report on Belarus from 13th March, 2015 (http://raexpert.eu/reports/Research_report_Belarus_13.03.2015.pdf)

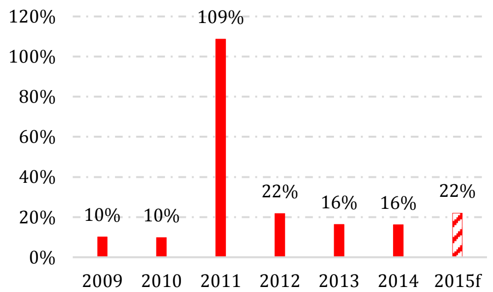
[3] In 2011, the Belarusian government approved a list of "socially important goods" for which the Ministry of Economy may impose price controls. The share of controlled "socially important goods" in the CPI basket fell to 25 percent in 2014 from 49 percent in 2011. However, the government retained the right to impose temporary price controls and price increases were prohibited for all goods and services at the end of 2014.

**Graph 3:** NBRB refinancing rate




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

**Graph 4:** Inflation rate




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

Apart from a USD 2 Billion support loan that helped Belarus bolster its reserves, the Russian government has pledged to provide additional support in the form of a waiver to pay duties to Russia on re-exports of Russian oil supplied at discounted prices. Russia has also indicated that it will refinance debt maturing this year. However, the recent volatility in oil prices, which will likely further worsen the economic position of Russia in 2015, could have a negative impact on the Belarusian economy.

**Impact of EEU on Belarus so far unclear.** Prior to the creation of the EEU, Belarus was a member of the customs union (since 2010), which allowed the country to trade freely with Kazakhstan and Russia. However, Belarusian exports to the member states have not increased significantly since then. Thus, Belarus is unlikely to benefit further from the EEU and improve its trade balance in the short- and middle-run. Additionally, several initiatives under the EEU, which could ultimately benefit Belarus, such as the creation of an integrated oil and gas markets and common regulatory and tariff polices, will not come into force until 2025.

Furthermore, Belarus faces stiff competition from the World Trade Organization (WTO) countries trading with Russia, as the custom tariffs move in line with Russia's involvement in the WTO rather than the EEU. Thus Belarusian consumers benefit from trade liberalization provided by the EEU, while Belarusian producers face harsh competition in Russia and Kazakhstan, which, unlike Belarus, have joined the WTO.

## Conclusion

The overall creditworthiness of Belarus remains negatively influenced by internal imbalances as well as vulnerabilities to external shocks. Moreover, inconsistencies in the monetary and exchange rate policies combined with inflation prospects contribute negatively to the assessment of the country.

However, sound debt load and fiscal balance present low risk for the country in the short- and mid-run. Recent moves of the government to refrain from increasing real wages beyond labor productivity growth and to cut the amount of directed loans contributed to the reduction of inefficiencies in the economy. Participation of Belarus in the EEU did not markedly improve the country's trade position, but Belarus could benefit significantly in the longer run.