BEROC Economic
Research Center

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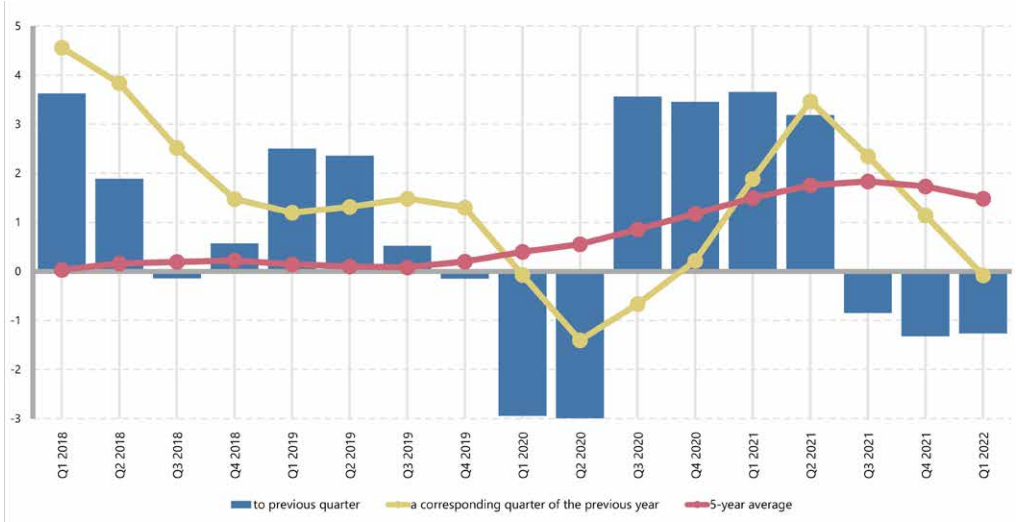
Economic Outlook

Q4 2021 — Q1 2022

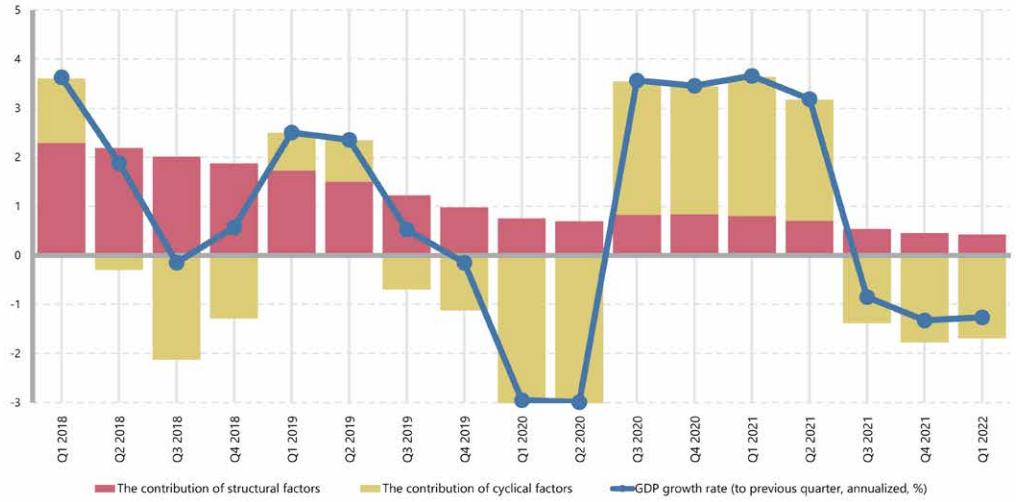
A Storm Instead Of The Expected Calm

- External demand is the key driver for output decline
- Inflationary explosion and authorities neglecting it
- A sharp decline in physical volumes of foreign trade, but the balance remains positive
- Liquidity in foreign currency: it is smooth on paper only
- Change of fiscal policy priorities?
- Salary zugzwang

GDP growth rate, % in annual terms (seasonally adjusted basis)



Decomposition of GDP growth: contribution of structural and cyclical factors, percentage points



1. Belstat traditionally presents the output growth rate (i) as a cumulative total (ii) against the corresponding period of the previous year. A series of such growth rates looks smooth, but new signals in the output dynamics are hidden there. There is a more common global practice to base the analysis of the GDP dynamics on the annualized growth rate between the last two quarters (considering seasonal adjustments of the series). Such growth rates clearly reflect the output trends that characterize the last quarter. A series of average annual growth rates (not cumulative) allows us to avoid high volatility of the previous indicator and review the last quarter data in the context of last year's growth. Finally, the average annualized growth rate over 5 years (not cumulative) can be considered as an indicator of the long-term growth environment. **Data for the latest period is a preliminary evaluation.**

2. The GDP is decomposed into structural and cyclical components by using one-dimensional static Kalman and Hodrick-Prescott filters. Final decomposition is the result of averaging between the two specified approaches. Such a decomposition presented in growth rates clearly illustrates the contribution of structural and cyclical factors to the output growth rate, but it does not focus on the current state (levels) of potential (trendy) output and the business cycle (the corresponding level estimates can differ much more significantly if other trend-cycle decomposition methods are used in relation to the growth rate estimates).

Current trends

Recession is inevitable. How fast and deep will be the recession dive in 2022?

Late 2021 and early 2022 faced a mild output decline. It was due to the cooling of the growth in the physical volumes of exports, although the foreign environment remained quite favorable. In this sense, output, after an overshoot in the first half of 2021, was getting back to its more natural trajectory. In the projections for 2022, considering the continuing global recovery growth and adaptation to the sanctions that were relevant at that time, there were reasons to believe that, at a minimum, the recession would be shallow and short. And under favorable circumstances, the restoration of anemic growth looked quite realistic.

However, the scales tipped towards a deepening recession in early February already due to the potassium transit ban introduced by Lithuania and the curtailment of production and exports associated with this. Such a sensitive blow in a short period promised an already tangible recession with output losses (from the peak in Q2 2021 to the bottom) up to 4.5%.
At the end of 2022, the decline in the case would not exceed 2.5%, and the output level at the end of the year would correspond to the period in early 2018.

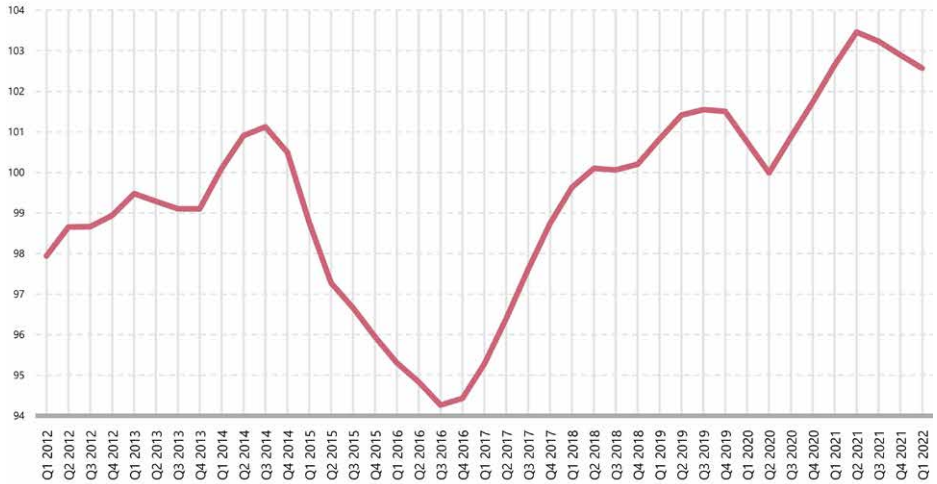
The Russian invasion of Ukraine has fundamentally changed the economic environment for Belarus. The sanctions of Western countries and their consequences, the almost complete destruction of trade relations with Ukraine, and the voluntary refusal of many counterparties from doing business with Belarus generated a large-scale and sustainable demand shock for the country: about 40% of exports cannot be delivered through the usual routes, and options to “redirect” exports are quite limited.

In addition to the demand shock, a supply shock also shapes in the new environment: the inaccessibility of intermediate imports, a new migration wave, and mental rejection of new conditions lead to the fact that a number of businesses limit their production. Finally, chronic threats to financial stability are also scaling in the new environment.
A deep recession has become inevitable under such conditions. The most pessimistic estimate of the recession’s potential bottom line is 20% (compared to the peak in Q2 2021), which corresponds to the income level at the turn of 2007-2008. However, the pace of submerging into recession, its actual bottom line, and its duration have not been predetermined yet. These characteristics will depend on how quickly and to what extent (foreign) supply and demand shocks can be contained and smoothed out.

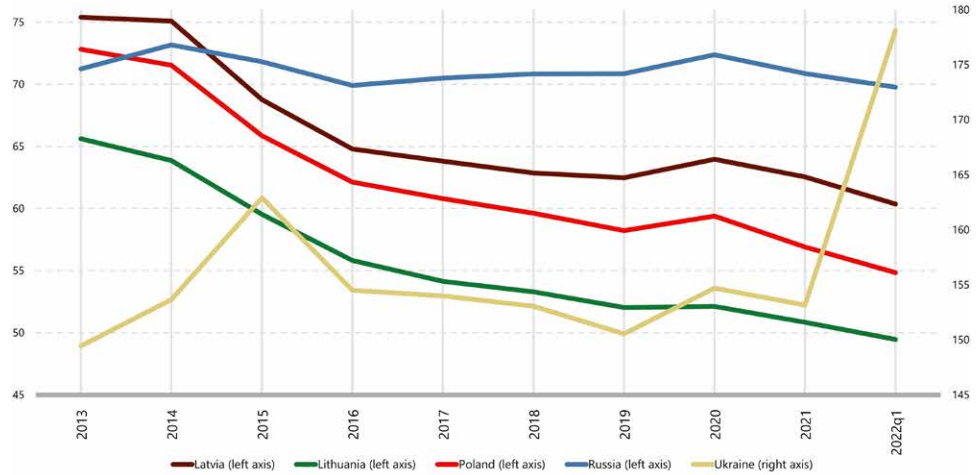
Operational data indicate that the track that the economy has been laying in March-June retains hope that the bottom line of the recession will not be so deep. If a forward movement along this track continues, output losses (compared to the peak in Q2 2021) will be about 6% by the middle of the year, and about 11% by the end of the year. In this case, GDP will decrease by 6-7% at the end of 2022, and its level will roll back to the 2010 GDP values. Deviating from such a track for the better seems unlikely due to lacking opportunities to quickly bridge the existing shocks. However, a deviation for the worse and even a tailspin of the economy in the worst-case scenario, e.g., due to growing intersectoral effects, financial turbulence, etc., seems quite probable still.

Development trends

Output, level, 2018=100

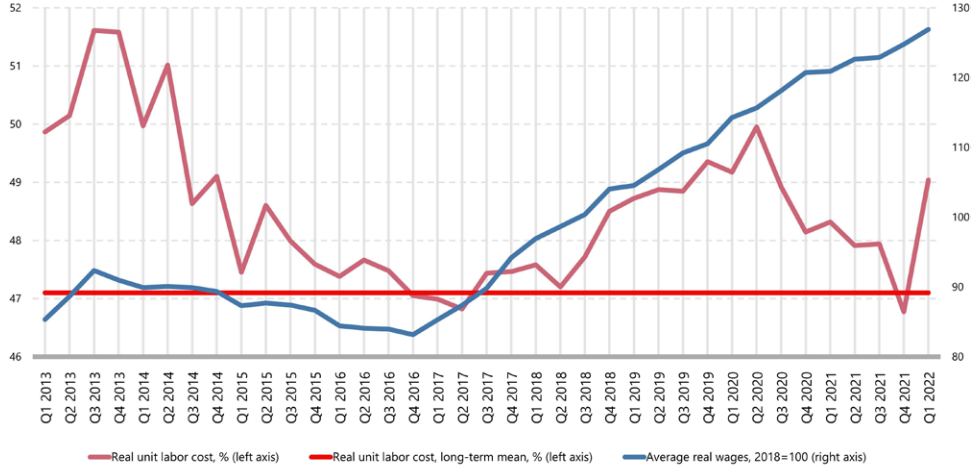


Relative well-being* in Belarus vs. its neighbors, %



GDP, domestic** and net external demand**, 2018=100

Real wages and real unit labor costs



* Well-being refers to GDP per capita at PPP in 2017 international dollars. Data from 2020 are estimates based on real per capita GDP growth rates in the reviewed countries. The indicator presented in the graph is the ratio of welfare in Belarus to welfare in the respective neighboring countries, in percentage terms.
** Domestic demand is shown excluding changes in inventories (investment in inventories).
*** The indicator of net external demand is calculated as the difference between the export and import indices according to the System of National Accounts (SNA), in which 2018 is the baseline, i.e. 2018=100. 100 is added to the obtained value for comparing it with other indices, in which 2018 is the baseline.

Institutional environment

From the swamp of uncertainty to the pool of impoverishment and regression

Today, the agenda is dominated by the question of how fast the recession is coming. E.g., the actions of the economic authorities are mainly aimed at making a smooth immersion into the recession. Against this background, the 2022 projection has revealed the most probable output track (approximately 11% decline compared to the peak in Q2 2021). However, there is no reason to believe by default that the bottom will be reached at this level by the end of 2022 and the recession will end. In a long run, the key characteristics of a recession are the depth of the bottom and the duration of stay near this bottom.

The depth of the bottom depends, first of all, on whether the authorities manage to find ways to revive the production of potash fertilizers and oil products, and if so, then how quickly. For both groups of goods, access to seaports and cargo logistics to the ports are critical issues. For oil products, the issues of reverse excise duty and/or reduction in the input cost of Russian oil are also important.

To determine the depth of the bottom, the issue of "redirecting" the exports that cannot be delivered via traditional routes (EU, Ukraine) is vital. Under normal conditions, the solution to this issue would be reduced to the categories of price and profitability. In the context of tough sanctions, these are, first of all, issues of transportation and logistics, as well as the settlement arrangements. Today, the answers to these questions are mostly beyond the scope of the economy: some of them are in the political plane, and some of them are almost random. Therefore, for the time being, an extremely wide range in assessing the bottom of the recession remains relevant: from about 7% to 20% compared to the peak in Q2 2021. If reality gravitates towards a bad scenario, and the plunge into recession is slowed down due to a combination of reasons, then the process of reaching the bottom can be as long as 5-10 quarters. That is, the whole of 2023, following 2022, may turn out to be a recession year.

By default, there is no reason to expect a quick recovery after sinking to the bottom. First, the bottom level is likely to correspond to the new equilibrium output level, while growth drivers will still be in short supply, and the growth potential will be close to zero. Second, a sharp structural contraction can itself become a factor destructing the economic environment and growth drivers. E.g., it can cause a full-blown financial crisis and a scaling supply shock (forced or voluntary refusal of businesses to operate in a new environment). Against this background, there is no clear prospect and new factors to generate growth.

The new big picture looks bleak. However, the scope of uncertainty has somewhat narrowed. In early 2022, anemic growth, stagnation, and a deep decline seemed probable in 2-3 years. Today, the vector of economic contraction clearly dominates: a decline in income and economic regression seem almost inevitable. The uncertainty comes down to how deep and how long they will be.

Info background

War and sanctions

Western countries have qualified the role of Belarus in the Russian invasion of Ukraine as an accomplice of aggression; and due to that, they have adopted new packages of tough sanctions. Their core is a ban to buy and transport key products of the Belarusian exports. The second component — financial sanctions — includes disconnecting a number of Belarusian banks from the SWIFT system, a ban on transactions with them and with the Belarusian public debt. Selective sanctions complete the circle by banning transactions with individual companies and individuals. In addition to direct effects, sanctions generate indirect effects, too. E.g., many non-residents — guided by precautionary or reputational reasons — refuse to deal with Belarusian counterparties. This creates additional transportation, logistics and payment barriers. In view of all of the above and taking into account the inevitable collapse of exports to Ukraine (about 13% of total exports) against the backdrop of the war, about 40% of all Belarusian exports are under threat. Taking into account the supply shock developing against the backdrop of the sanctions, there is a risk of losing up to 20% of output in a bad case scenario.

Seeking financial support from Russia

The authorities have traditionally tried to get support from Russia against the backdrop of a sharp deterioration in the economic situation. Minsk has managed to get a revision of the schedule of the public debt repayments to Russia and to the Eurasian Fund for Stabilization and Development (EFSD) in 2022 (for about USD 1 billion). With reservations, one may consider the transition to the nomination of prices and payments for the supply of Russian gas and oil in Belarusian rubles as some achievement. At the same time, the benefits generated by the relations with Russia have significantly and automatically increased against the backdrop of the sanctions and the war. The gas price has started declining for Belarus at the expense of the growing global gas prices. The input oil price for Belarus has also decreased in relative terms due to sharp discounting of the global price for the Urals oil (compared to other grades of oil). The departure of many foreign companies from the Russian market and the depreciation of the Belarusian ruble in comparison to the Russian ruble have strengthened the positions of Belarusian exporters.

Targeted anti-crisis measures, recapitalization of state-owned banks and budget emission, games with public debt

The authorities have started to actively use specific know-hows due to lacking standard instruments of the economic policy. These include government budget support provided to state-owned enterprises, export credits, restrictions to export a number of goods, and direct price regulation. Moreover, targeted sectoral measures have been launched as part of the anti-crisis plan. However, all this can only somewhat smooth out and slow down plunging into recession. Growing disproportions forced the authorities to resort to more radical steps. These were the budget issue (the National Bank bought government bonds for BYN 1.3 billion) to recapitalize state-owned banks, and the authorities also played with the external public debt repayments. The authorities approved settlements with “unfriendly” creditors in Belarusian rubles. Later, the same arrangement — with reservations — was extended to Belarusian Eurobonds, too. This will very likely lead to the fact that rating agencies will announce a default on the Belarusian public debt.

Output and demand

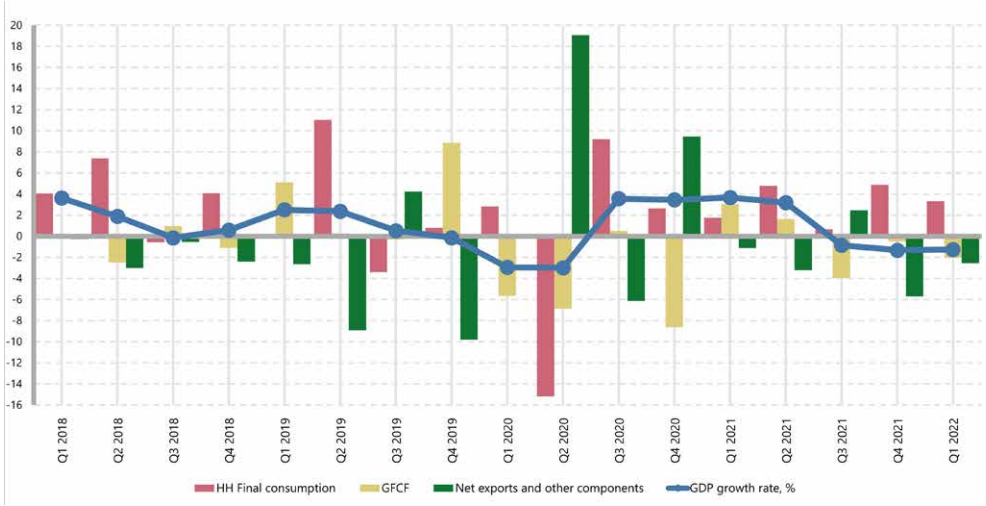
External demand is the key driver for the GDP contraction

On the demand side, the deterioration in net exports was the key driver of the decline. However, its level from the standpoint of macrobalance has remained acceptable so far (positive in real terms). In this sense, the initial decline period is still associated with the "eating away" of the safety margin in the external position formed during the period of the foreign trade miracle. However, this safety margin has almost been exhausted. Therefore, the likely further deterioration of the external position will not only deepen the recession, but also lead to macro-disproportions.

The decline was offset by household consumption, which continued to grow. This growth reflected the inertia of real incomes in Q1, as well as the response to shocks in the foreign exchange rate, inflation expectations, and prices. In subsequent periods, these effects will most likely run out and household consumption will reverse its trend. The potential of the consumption decline among the elements of demand seems to be the most significant: consumption reached its historic peak in Q1, both in absolute and relative terms.

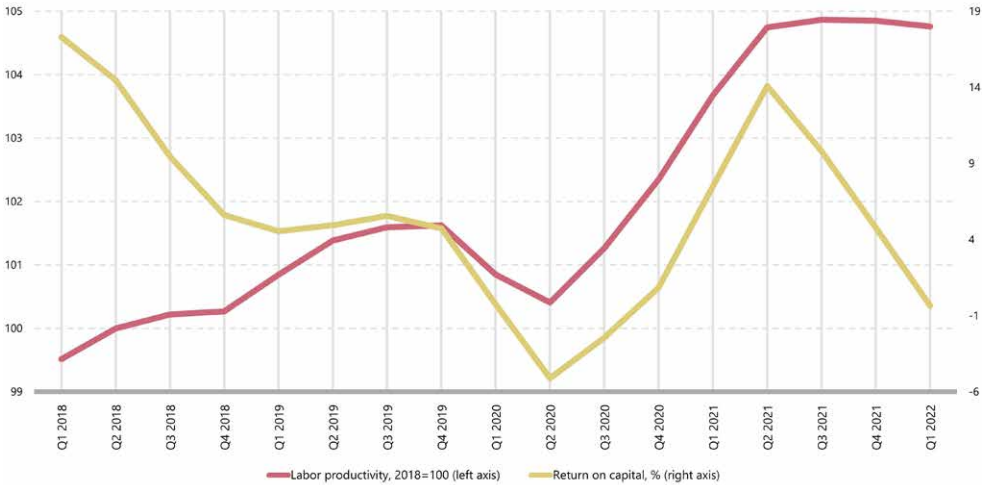
On the supply side, the agriculture, manufacturing, construction, and IT sectors contributed positively to the output dynamics in Q1. However, growth in these sectors (with the exception of IT) was not a manifestation of a sustainable trend: it was modest and in most cases was a kind of rebound against the backdrop of a favorable market situation in the pre-war months. The main downturn contributors were the transport, energy, and trade sectors.

Contribution to output growth, percentage points



Note: The GDP growth rate and the corresponding contributions of the demand components are presented in an annualized form relative to the previous quarter (seasonally adjusted); GFCF (gross fixed capital formation).

Qualitative indicators of economic growth



Note: The return on capital proxy is calculated as the ratio of the average annual output growth rate to the GFCF's share in GDP.

Monetary environment

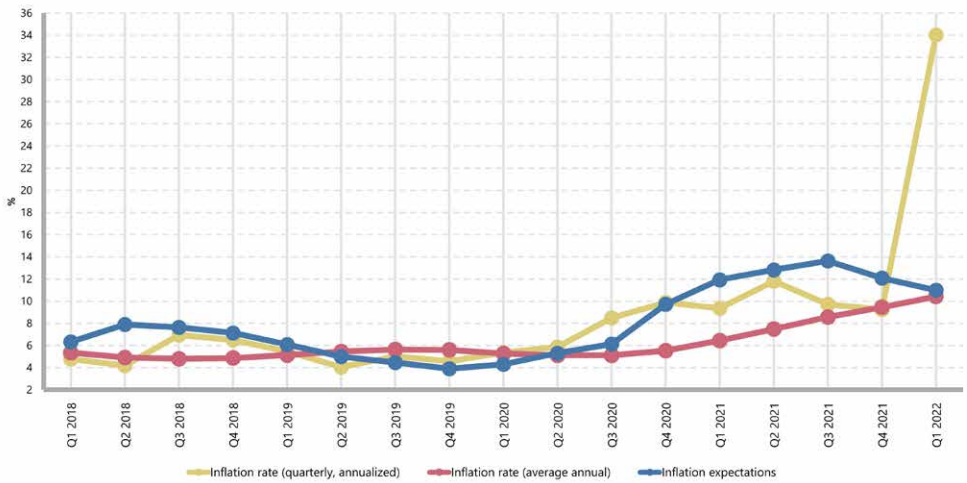
Inflationary explosion and authorities neglecting it

Inflation had been steadily elevated prior to the war (about 10%). As the war started, there was a large-scale price shock due to the sharp leap in the foreign exchange rate, sanctions and related shocks, rising inflation expectations, etc. Cumulative quarterly inflation soared to around 34% (annualized).

The monetary authorities' response was disproportionately small. There was a modest interest rate increase and contraction of monetary aggregates, as well as targeted response measures. This reticence has been probably due to two reasons. First, the inflation target began to strongly conflict with the goal of maintaining the output, and the latter was prioritized. Second, the authorities probably perceived the price shock against the backdrop of the war and the sanctions as an inevitable and one-time shock, and therefore, they decided not to suppress it.

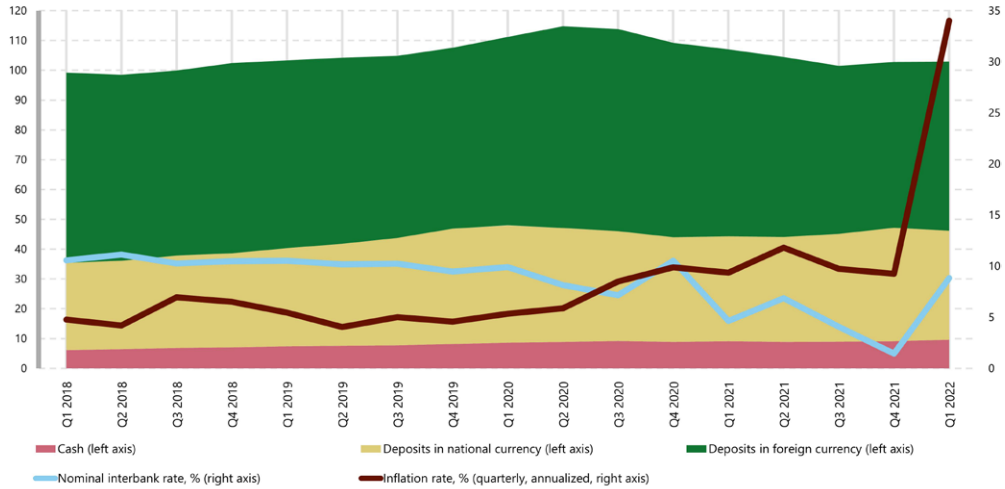
The authorities probably expect that the price shock will be one-time, and, in the long run, inflation will begin to fade against the background of income and output contraction. This is possible if the rollback and stabilization of the BYN/USD foreign exchange rate turns out to be there for long, and monetary policy, at least, will not soften. However, both seem unlikely. At that, the list of pro-inflationary factors is still wide: limited access to imports (due to sanctions, etc.), accelerating global inflation, supply shock. Therefore, at least a long-term fixation of inflation in the range of 15-20% or further unwinding of the inflationary spiral seem more likely.

Inflation and inflation expectations, %



Note: Inflation expectations are calculated based on the Kruk methodology (2016). All indicators are given as a percentage, in annual terms. Quarterly inflation is seasonally adjusted.

Interbank interest rate and monetary aggregates



Note: The M3 components are given on the basis of the M3 2018=100 scale. All indicators are seasonally adjusted in real terms.

Financial stability

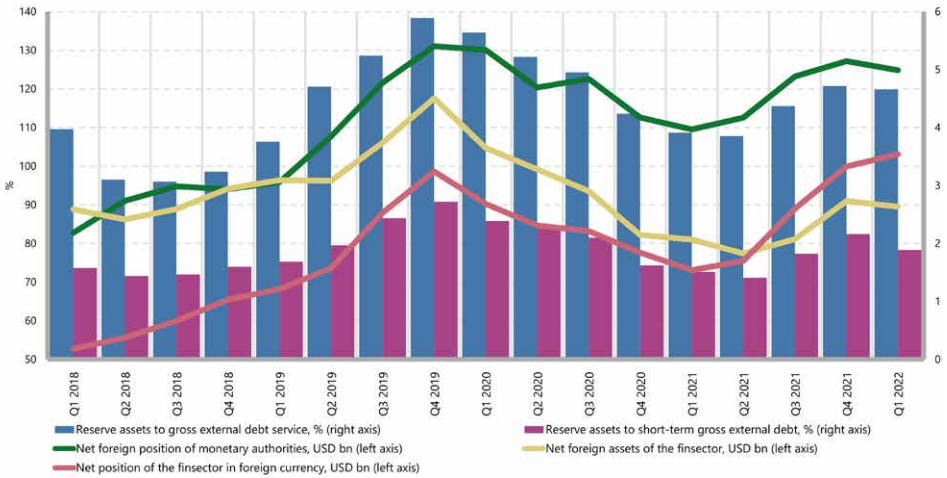
Liquidity in foreign currency: it is smooth on paper only

Prior to the war, foreign currency liquidity indicators had continued a gradual growth trend. Against the background of the started war, the foreign exchange rate leap, the increased demand for foreign currency, the outflow of foreign currency deposits, etc. broke this trend. At the same time, the terms and conditions of trade and trade balance remained favorable facilitating the inflow of foreign currency into the country. Therefore, according to statistics, deterioration of the foreign exchange liquidity does not seem to be particularly significant. However, today's statistics on foreign exchange assets may not reflect the reality adequately. The key reason for this is the freezing of the National Bank's reserve assets under the EU jurisdiction. Based on public data, it is impossible to reliably estimate their value, but indirect evidence suggests that frozen assets account for about 20% of all reserve assets. Moreover, under the current conditions, it is highly likely that Belarusian residents may not be able to dispose of their foreign assets de facto, even if the assets are not de jure frozen. Hence, lacking foreign currency liquidity is still seen as one of the most tangible risks to financial stability.

Private debt burden rising again

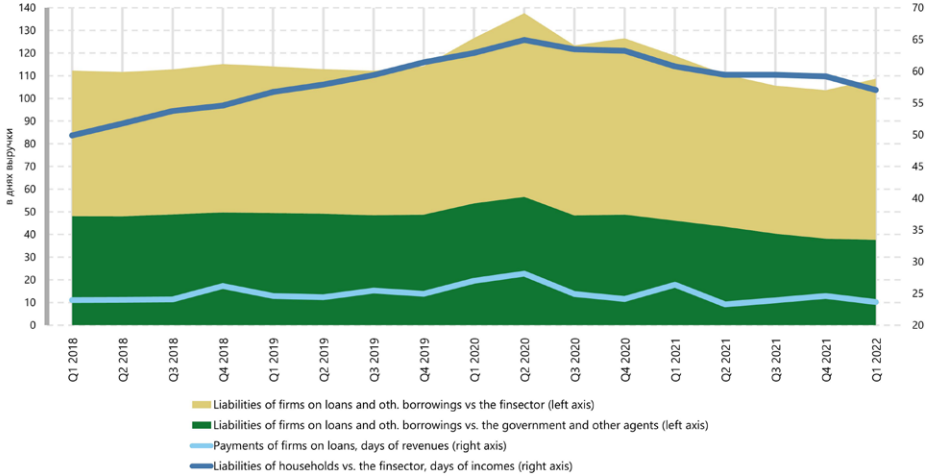
The amount of debt on loans in the economy has increased significantly (mainly due to the revaluation of foreign currency loans), while revenue growth has slowed down. Therefore, the long trend of reducing the debt burden has ended, and the debt burden has started growing again.

Foreign currency liquidity indicators



Note: Reserve asset indicators are given as of the beginning of the quarter. Servicing of the gross external debt includes interest and principal payments for the previous 12 months. The net external position of the monetary authorities is calculated as the difference between reserve assets and their contingent costs over the next 12 months.

Indicators of the size and quality of private debt



Note: The debt of firms on government loans, etc., is calculated as the difference between the total debt of firms on loans and their debt on loans to the financial sector.

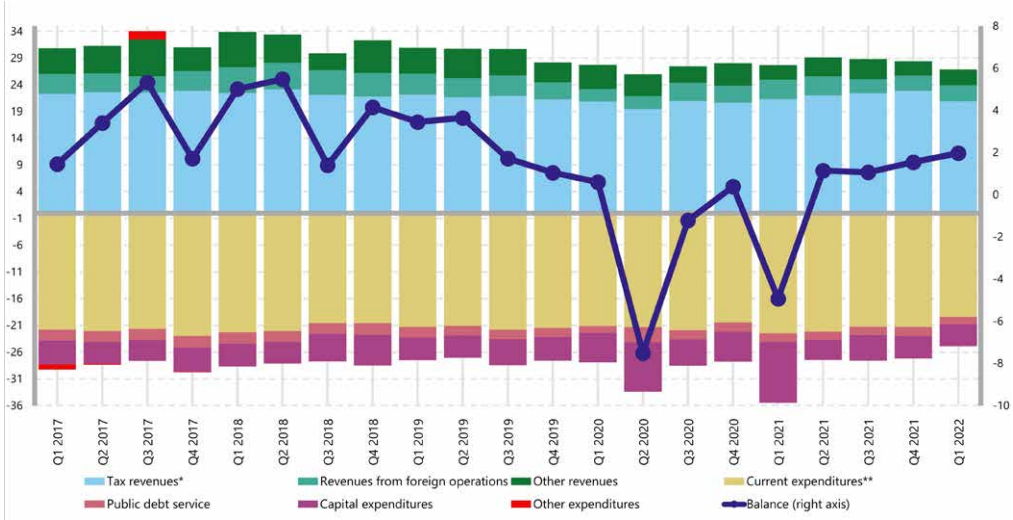
Fiscal environment

Changed fiscal policy priorities?

When looking at the Q1 2022 results, the budget looks exciting. Although the medium-term forecast shows a sustainable deficit, the budget has continued to run with a surplus. This result, firstly, was achieved because the contraction of income (in % of GDP) — due to the favorable foreign market situation — has been smooth so far and not so significant. Secondly, the government, probably considering the fact that a new deteriorating normality for the budget is around the corner anyway, has been preventively compressing spending (in % of GDP). In Q1 2022, spending was almost 4% of GDP less than average spending in 2019-2021. The flip side of this approach was that the fiscal policy impact on the GDP dynamics (fiscal impulse) was negative in Q1 2022.

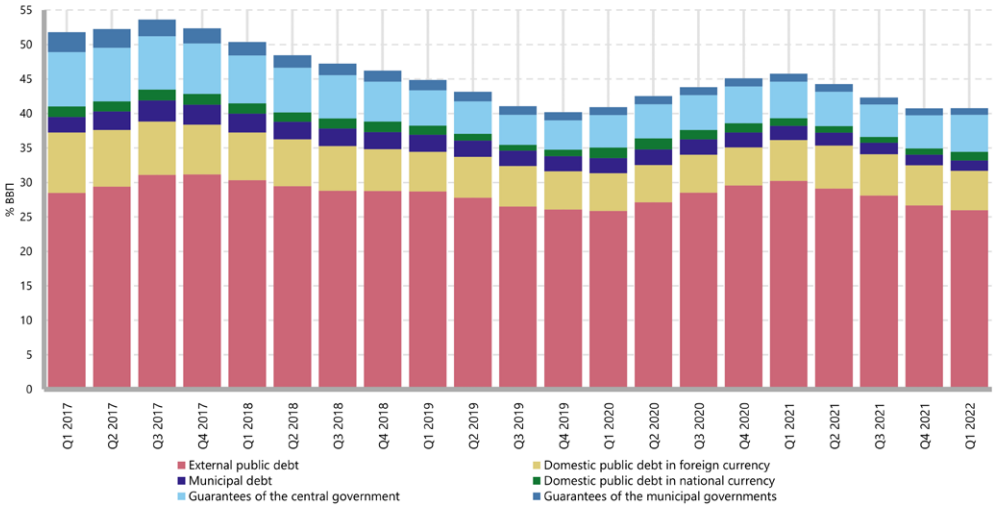
In the context of sanctions, the contradiction between fiscal sustainability and the direction of the fiscal impulse has intensified. As the recession deepens, the authorities are unlikely to dare to continue to tighten spending. This is especially problematic in view of the growing financial problems in the sector of state-owned enterprises and state-owned banks. In this regard, recapitalization of state-owned banks that happened in April will probably not be a one-time action, but will mark a new fiscal policy milestone. It is most likely that at least the budget deficit allowed by the authorities (about 2.5% of GDP) in 2022 will be implemented de facto. A steady transition to the budget deficit in the given conditions (due to numerous structural flaws) is fraught with the development of an inflationary spiral and/or financial cataclysms (e.g., associated with the public debt).

Consolidated budget performance, % of GDP



Note: * - without taxes from foreign economic activities; ** - without servicing the public debt. Data in % of GDP are shown as seasonally adjusted quarterly flows.

Public debt, % of GDP



Note: Average per quarter.

Foreign environment

External price dynamics favor Belarus

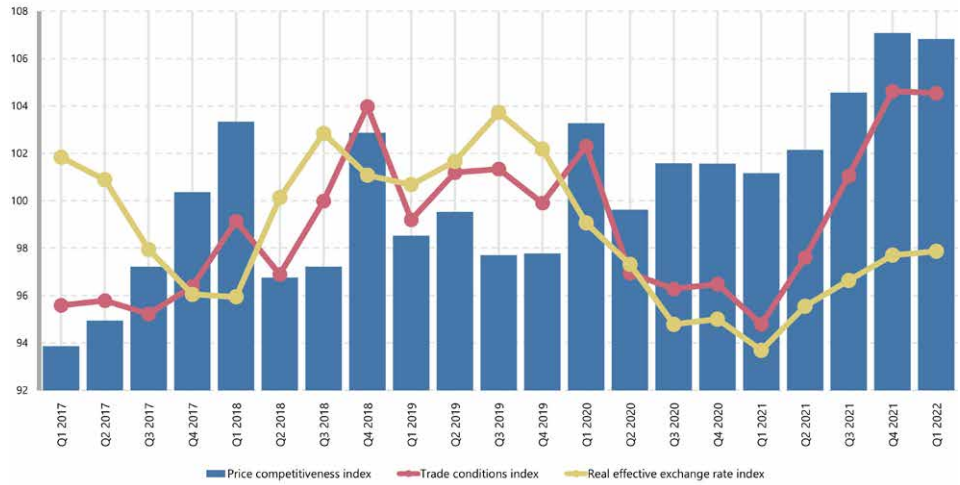
Price competitiveness has remained close to its 5-year peak. This has become a key factor in the foreign trade surplus in monetary terms. In turn, it has been the main damper of issues in the economy against the background of the war and the sanctions.

High price competitiveness is ensured by the terms of trade. Export prices are rising naturally, driven by global inflation and commodity price peaks. Import prices are growing at a slower pace since prices for a number of key goods from Russia (gas, oil, etc.) are fixed or their growth is being restrained. The real foreign exchange rate (ceteris paribus, it would have strengthened) has remained almost unchanged due to following the trend of the Russian ruble and due to the financial panic after the war broke.

Global growth slows, inflation accelerates

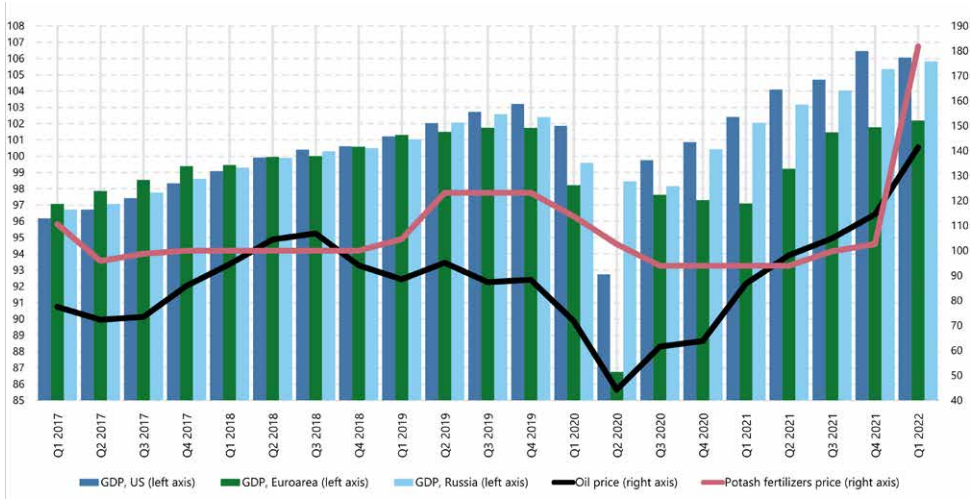
Before the war, the main global challenge had been inflation. It had crept up to the double-digit figures in developed countries for the first time in 40 years. The need to address the inflation had posed a key risk to growth prospects, although they had been largely viewed as still moderately optimistic. The war worsens output prospects directly and also exacerbates (through food and energy pricing) the inflation challenge. Therefore, global economy forecasts and expectations have deteriorated significantly. Sliding into stagnation and possibly even into a new recession becomes quite probable in 2-3 years.

Price competitiveness indicators, 2018=100



Note: The Price Competitiveness Index (PCI) is calculated as the product of the Terms of Trade Index and the indicator reciprocal to the REER (Real Effective Exchange Rate) index multiplied by 100.

Global economy indicators, 2018=100



Note: All GDP series are seasonally adjusted. Commodity price indices are calculated based on the World Bank data.

Foreign operations

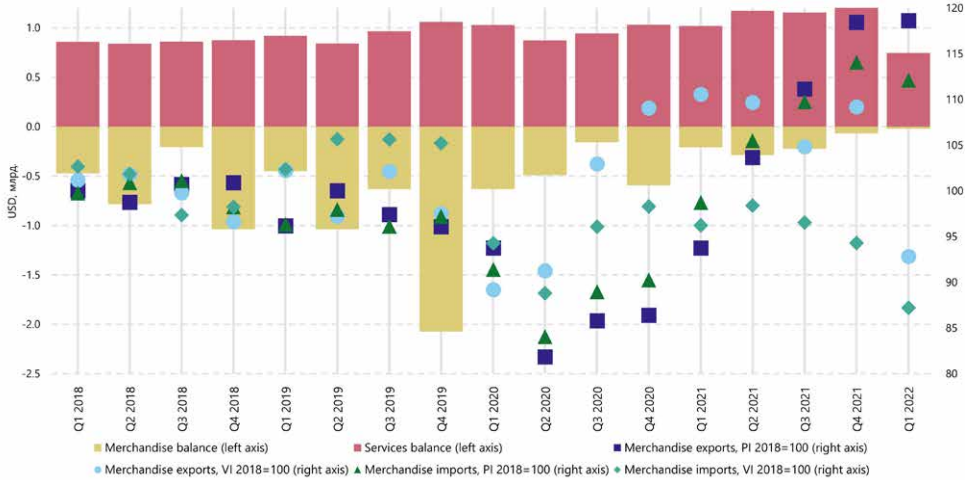
Physical volumes of trade fell sharply, balance is positive

Before the war, the state of foreign trade had been attractive. The physical volume of exports, although it had stopped growing, had been close to its historical highs. At the same time, the physical volume of imports had been significantly lower than the level that, based on retrospective estimates, could be considered equilibrium. Finally, the trade balance in monetary terms had been positively impacted by the terms of trade. With the outbreak of the war, the situation changed dramatically. Along with the new sanctions, it has become impossible to use the Ukrainian market as a shock absorber for the old sanction packages. De facto, the degree of influence of the latter has increased dramatically. These reasons have led to a gigantic contraction in the physical volume of exports starting from March. If compared to the peak levels in 2021, it has decreased by about 40% (about 25% from the 2019 average). However, the trade balance remained positive (in both real and monetary terms) as imports contracted in proportion to exports, and the terms of trade remained attractive. Therefore, the vicissitudes of foreign trade have not deteriorated the external position and the related macro disproportions yet. However, trade contraction has become the driver for the output reduction.

Belarusian Eurobond market is dead. R.I.P.

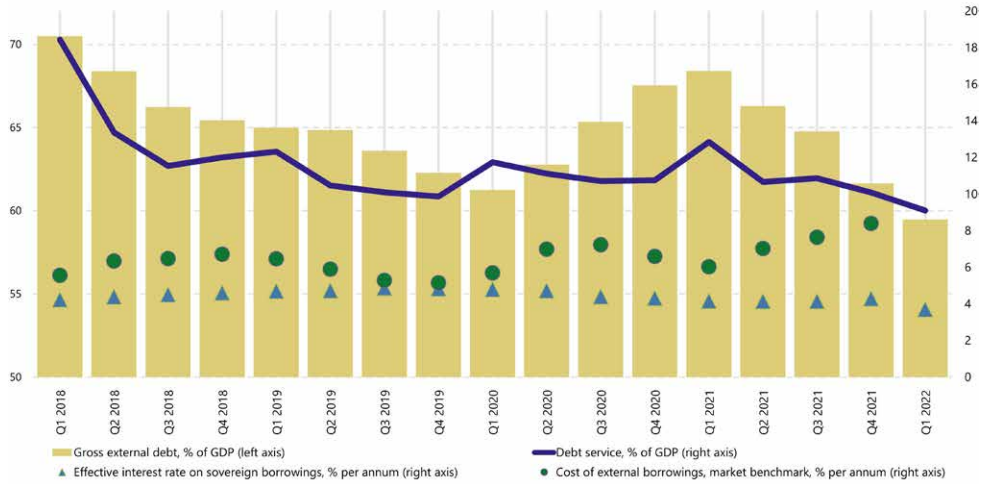
As the war broke, the quotes for the Belarusian Eurobonds collapsed at the Western stock exchanges, trading within 15-20% of the face value, and Eurobond transactions got scanty.

Prices and physical volumes of foreign trade, 2018=100



Note: PI (Price Index); VI (Volume Index). The indices are seasonally adjusted and the trade balance is not.

Size and cost of external borrowings



Note: Debt service as a percentage of GDP takes into account both interest payments and principal repayments. The effective rate is calculated as the ratio of interest payments on public debt to its average for the last 4 quarters. The cost of sovereign loans is an estimate of the average yield to maturity on all issues of sovereign Eurobonds in circulation.

Social context

Salary zugzwang

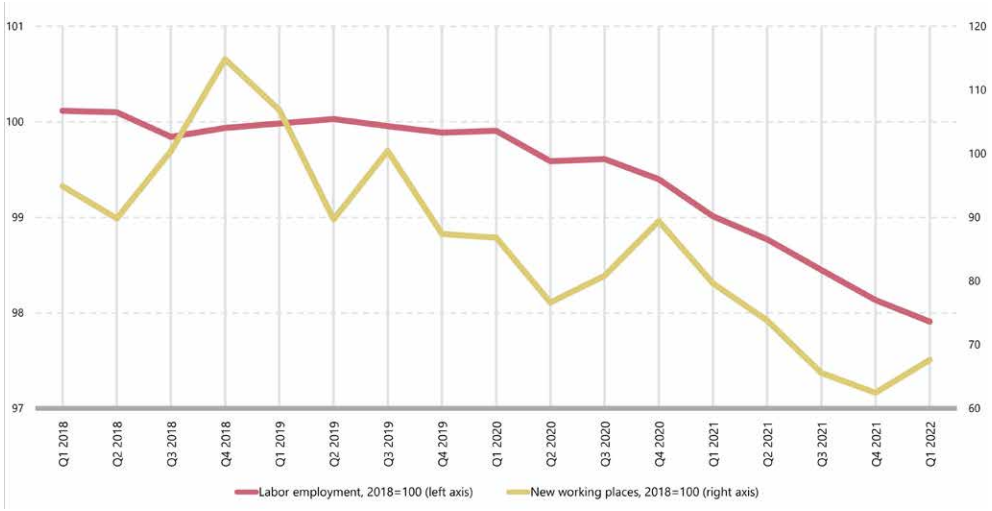
Several consecutive years of growth in the average real wage raised it to a level that, under the new conditions, seems to be too high. E.g., the real unit cost of labor rose sharply, breaking away from its equilibrium level again.

In March, due to the inflation pressure, real wages sank sharply (by 9.5% compared to February, adjusted for seasonality; although, quarterly average wages increased due to the pre-war months). Such dynamics is seen as an adaptation to a new equilibrium level. Therefore, it can be regarded as inevitable and expedient, up to groping for the bottom of the recession. Also, wage cuts seem to be a lesser evil than the threat of rising unemployment (however, the latter, has been at its historical minimum of 3.7% so far due to decreasing employment).

However, it is likely that the authorities will resist the decline in wages. First, this is because of the fear of social unrests. Second, a sustained wage squeeze can open up a Pandora's box in the form of a new round of deepening recession impulses. After all, household consumption is still the main shock absorber of the recession, which, in turn, is due to unreasonably high wages. However, if the authorities switch to actively supporting wages, then this is fraught with price and/or financial destabilization.

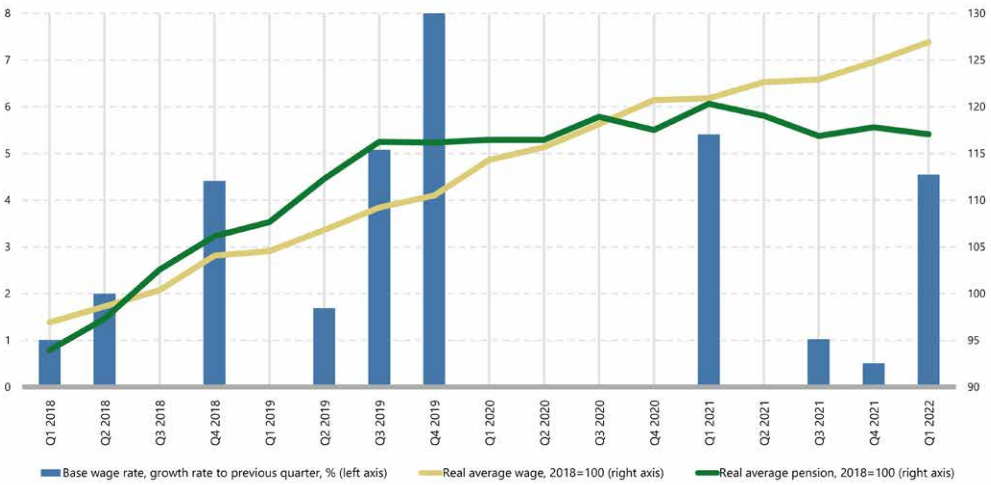
Thus, there is a paradoxical situation about wages: any future dynamics of wages is fraught with serious macro-disproportions and complications.

Employment and new working places, 2018=100



Note: The indices have seasonal adjustments.

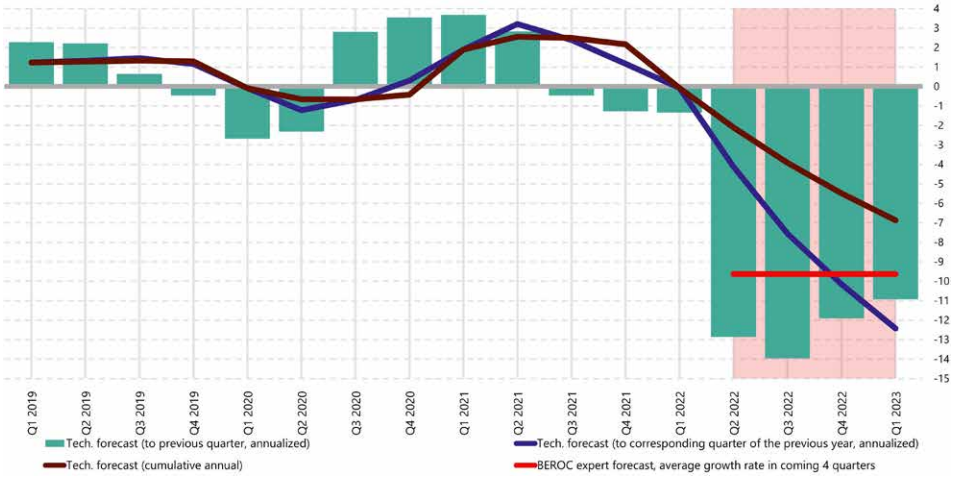
Base wage rate and household income



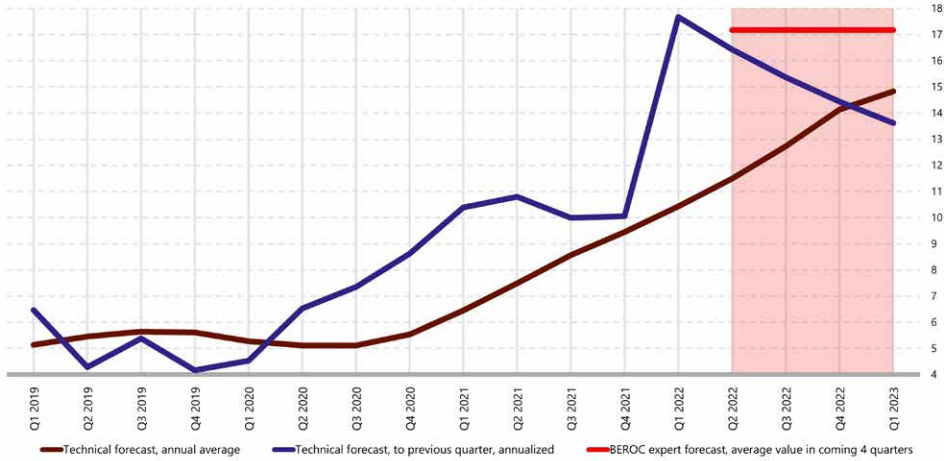
Note: The indices have seasonal adjustments.

Technical forecast

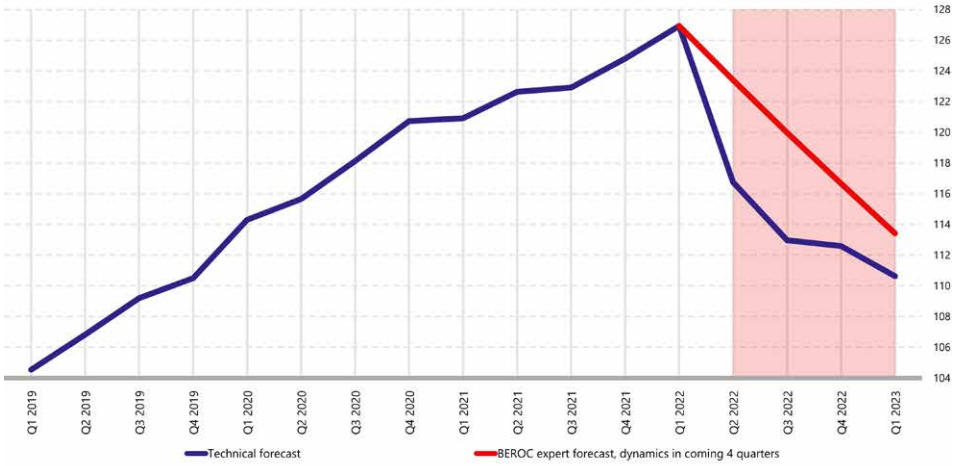
Output, growth rate, %



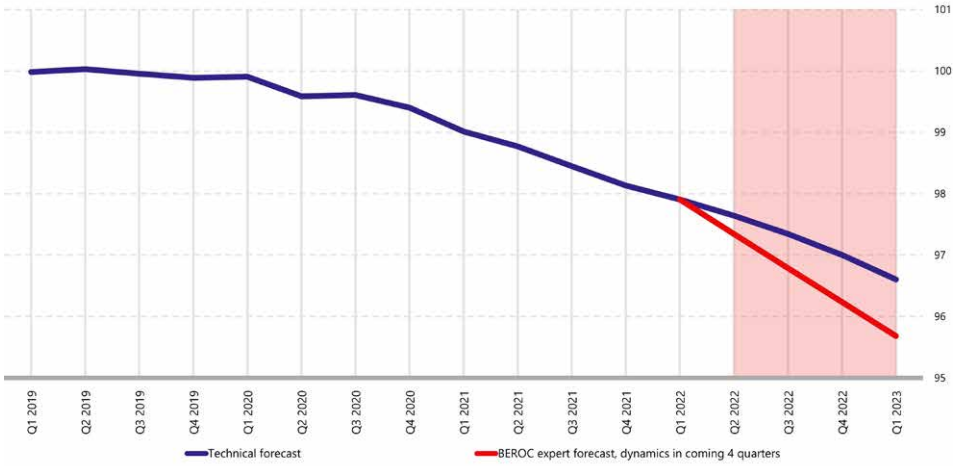
Inflation, average annual, %



Real wages, 2018=100



Employment, 2018=100



A technical forecast is an automated forecasting procedure. This procedure involves selecting the best ARIMA model specification for a given series based on the Akaike information criterion (AIC) and forecasting 4 quarters ahead based on the selected model. The forecast based on the ARIMA model takes into account only the past dynamics of the indicator under consideration and does not link this indicator with other economic variables, either in the past or in the future. The "technical forecast" term emphasizes that the forecast does not take into account economic relationships in any way, and it is based on statistical patterns only. This forecast can be best interpreted as an answer to the question "What will happen to this indicator in the short term under the inertial scenario, i.e., if the fundamental characteristics of the economic environment remain unchanged, the economy will not be affected by exogenous shocks, and fiscal and monetary policy will not change compared to the current period?" The BEROC expert forecast is the medium-term equilibrium value of the corresponding indicator, i.e., the value to which the latter will strive over the next 4 quarters.

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The publication draws upon information and data of the following:

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Ministry of Finance of the Republic of Belarus (www.minfin.gov.by)

National Bank of the Republic of Belarus (www.nbrb.by)

International Monetary Fund (www.imf.org)

R Core Team (2017). R: A language and environment for statistical computing. R Foundation for Statistical Computing, Vienna, Austria. URL https://www.R-project.org/.

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