Belarusian Economy Creeping into Recession

The first quarter of 2015 displayed a number of distressing trends in Belarusian economy.

The adjustment of the exchange rate has not secured the restoration of competitiveness. Furthermore, the government has to resort to conservative policies for mitigating structural weaknesses.

The economy has gone into recession, which was accompanied by lower real wages and levels of employment. However, a tough environment may become a trigger for structural reforms.

A New Economic Pattern: Shrinking Economy and Conservative Policies

The first quarter of 2015 has been distinct because of some of the novelties witnessed in economic dynamics and policies. A couple of months ago, the low competitiveness of Belarusian goods had become a key reason for the exchange rate's adjustment. But this time around, the authorities have minimised the impact of devaluation, as they were afraid of a new full-fledged financial crisis.

Hence, they have been deferring to 'austerity policies' to mitigate structural weaknesses and to restore competitiveness. Such policies include constraints on wages, fiscal expenditures, and a rather conservative monetary policy.

This scenario has changed the traditional landscape. First, the government has thus far refused to engage in a policy of wage stimulation. More than this, the government has actually begun to restrain wages, for instance, like those found in budgetary sector, and through administrative measures. Hence, a trend of real wage contraction has become persistent.

Figure 1. Cyclical Component of GDP

Note: Seasonally adjusted.

Second, a new reality has expressed itself through declining levels of employment and growing unemployment. Official statistics only report registered unemployment. In the 1st quarter it grew by 8.6%, reaching 0.9% of labor force. However, the absolute value of official unemployment is rather far from the actual figure. But, its growth rate may be used as a proxy for showing actual unemployment. Given the assessments of the latter at around 4.5% in December, one may argue that currently, the actual rate of unemployment tends is climbing towards its historical maximum from the last decade.

The new environment has resulted in a contraction in economic output. In the 1st quarter GDP fell 2%. The scope of this contraction seems to be relatively modest, as the depressed environment has also led to a tremendous contraction in imports. However, a mitigating recession due to fewer imports might be exhaustible: roughly all of the options for import restrictions have already been invoked. Hence, the additional competitiveness of enhancing the policies employed are necessary in order to ensure that the recession will continue to be modest and/or short-lived.

Sustainable Weaknesses May Secure Long-Lasting Recession

During the 1st quarter, Belarusian exports saw a significant decline. However, the adjustments in the exchange rate for the Belarusian ruble and the ‘austerity policies’ in place helped to mitigate this trend. Being accompanied by rapidly contracting imports, it helped to secure rather attractive foreign trade statistics.

For instance, the trade balance (goods and services) in January-February turned was in the green. From the perspective of current accounts, this means that it is likely to shift upwards into the positive in the first quarter as well (especially, taking into account that oil duties are going to the Belarusian budget this year, while previously they were being sent to Russia).

Improvements in its external positioning assisted in stabilising the exchange rate. The latter pushed the households to deposit more actively in the Belarusian ruble as they try to take advantage of a period of high real interest rates. This, in turn, created an impulse to drive interest rates down on financial markets. The authorities have begun to argue about stability and Lukashenka has characterised it as ‘a certain equilibrium between the economy and finance’.

But in a broader context, the situation remains far ideal. First of all, despite improvements in foreign trade, international reserves continue to shrink (see Figure 2).

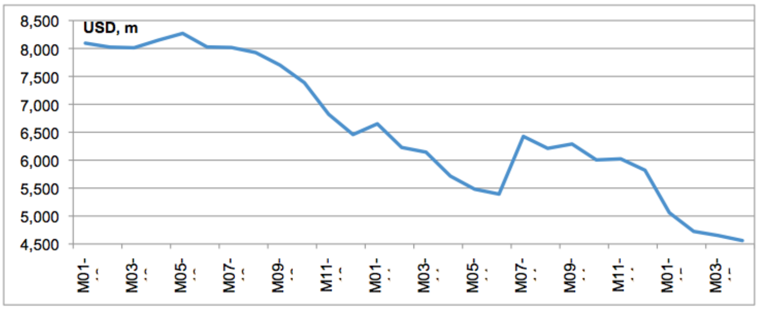

Figure 2. The Dynamics of International Reserves

Payments towards external debts are the main culprit behind this development. Moreover, future payments due this year will lead to a further decrease of the reserves, unless some of the debts are not be refinanced.

Second, devaluation and inflation expectations are still high and not sustainable. Hence, any serious shock may generate a new wave of disturbances on domestic financial markets. From this perspective, dwindling reserves is alarming, as just it may trigger new financial turmoil.

Third, while the current policies have improved the competitiveness of the firms somehow, but the situation is still far from normal. A majority of firms still cannot restore their financial position because a huge part of their working capital is frozen in the pipeline. For instance, manufacturing firms have accumulated 84% of their monthly average production as finished goods inventories.

These frozen inventories can simultaneously cause a number of other events to unfold. First, the share of borrowed funds (bank loans) in firms' working capital is increasing, substituting their frozen funds. Given the high interest rates, these will only worsen firms' financial positions. Second, the lack of liquid assets influences the growth of non-payment in the real sector. Third, firms have to restrict their output, make further cuts in wages, which generate negative impulses for output patterns. Hence, the overall lack of competitiveness is likely to make the current recession deeper and more prolonged.

Authorities Apply for New Credit, Promising Structural Reforms

The authorities suffer from a lack of available instruments to smooth over the recession and reduce its potential length. Hence, their search for a new chunk of external financial support has once more become their primary target to solve the issue. In March and April they launched negotiations with Russia, the EurAzEC anti-crisis fund and the IMF for new funds.

However, the government is trying to show (albeit indirectly and without issuing any official statements) that this time is different – they are not just applying for more credit, but they want to use these funds as a kind of umbrella for structural reforms. For instance, a visit by the Belarusian authorities to the IMF's Spring Meetings included a presentation on a structural reform ‘road map’ that had been developed in cooperation with the World Bank. This ‘road map’ contains a wide range of measures, which indeed could lead to systemic structural reforms, if it were to be implemented.

However, there are still doubts amongst the Belarusian public about the willingness and readiness of the authorities to start the reforms. Given their negative past experiences, many experts argue that the agenda for structural reforms is simply being used as a justification for filling the state's coffers. It is up to the authorities to show what their real intentions are in the coming weeks and months.

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