The Government is Preparing for a Recession – Belarus Economy Digest

For 2015, any positive growth would be considered a great success for the Belarusian authorities. Apart from external shocks, several structural challenges have emerged.

A spike in inflation, deeper depreciation of the national currency, the distress of the banking industry, and growing unemployment have all become urgent issues that must be addressed.

The government is trying to formulate a coherent response to all of these issues. So far the signals from the government suggest it is going to focus on tools of direct administrative control.

Economy in 2014: Weak Growth

In 2014, the Belarusian economy grew by 1.6%. Weak GDP growth demonstrated once more that the Belarusian economy has all but extinguished its potential for high growth. In other words, prior structural weaknesses continue to plague the economy.

However, cyclical factors also contributed to weak growth. In the spring and autumn a slow, but uneasy recovery took place. Since autumn, the economy started to suffer from lower demand from Russia, cheaper oil prices (which it re-exports from Russia), and deterioration in domestic agents’ expectations. Finally, in November and December, these factors overwhelmed the weak roots of the economic recovery. Since then, the Belarusian economy has started to dip into a recession again (see Figure 1).
Preconditions for a Recession in 2015

In 2015, the environment for the Belarusian economy will deteriorate further. First, a recession in Russia seems all but inevitable. During the last couple of weeks a majority of forecasts for the Russian economy have come to the consensus that its GDP is going to shrink by 3-5% in 2015. For Belarus, this means that the country can expect a further contraction in demand from Russia.

Second, Belarusian exports in Russia will suffer from a lack of price competitiveness. Despite the depreciation of roughly 40% against major currencies, price competitiveness is far from its ‘normal’ standing. For instance, the real exchange rate of the Belarusian ruble vs. Russian ruble remains much higher (15-20%) than it was just a few years prior. This will contribute to a further contraction in exports.

Third, real wages are declining due to wage policy restrictions and price growth. Reducing real wages will determine if a downturn in household consumption will unfold.

Fourth, the overall financial fragility, generally negative expectations, and high level of uncertainty will make banks
more reluctant to provide new loans. Interest rates will be unaffordably high for a majority of companies (as of today, a lower threshold for nominal rates for ruble loans are hanging hesitantly around 55% per annum). While other sources of financing capital investment are hardly accessible, capital investments will undergo a further contraction.

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Fifth, the financial position of companies has become another serious concern. Due to their sagging competitiveness, the profitability of Belarusian companies not dealing with finance has remained very low. The 'internal reserves’ for a majority of companies, especially state-owned ones, have already been exhausted. Hence, many companies will either need one or another form of financial support (permission to raise prices, access to cheap loans, etc.), or will have to layoff employees.

Sixth, no affordable external loans are directly available as of today. Access to the IMF’s funds requires a strong commitment to structural reforms. New loans from Russia are hardly accessible, unless both parties agree on a new political deal.

Yesterday’s Problems May Look Like Success Today

The official forecast from the Belarusian government projects around zero GDP growth in 2015 (0.2-0.7%). However, it also assumes a more favourable environment than really exists at present. Taking into account the preconditions above, a recession is much more likely. However, projections for 2015 are still not clear. They depend on the extent and speed of the new problems that could soon appear as well as the government’s response.

First of all, there is the issue of an unstable and
unpredictable exchange rate. Fundamental factors at play will push further rouble depreciation. The latter may cause a new round of financial stress on the deposit market. However, the National Bank is still demonstrating a lack of clarity in its intentions. On the one hand, it is claiming to support a free floating currency regime. On the other hand, it fears a deposit withdraw shock, which could adversely affect exchange rates as well.

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Another issue is the relatively huge price overhang that has formed during the last month. If there were no price controls in place, the most optimistic projection for CPI inflation in 2015 would be 30% (official forecast project 12%). This kind of inflation will cause an additional push towards further depreciation. At the same time, long-term price controls will only enhance companies’ weaknesses and lead to a deficit in some commodity segments.

The poor financial standing of companies will require new financial injections. Moreover, deteriorating liquidity and a growing number of non-performing loans will push banks to seek cash injections too. This may result in pressure on the National Bank to soften its monetary policy. But the latter may become yet another trigger for an inflation-devaluation spiral.

So, the puzzle is extremely complicated and no good solution seems to be at hand. There are only really three major solutions still on the agenda. First, is the immediate launching of structural reforms, which will open access to cheap external funds (like, to the IMF) that are able to help mitigate the recession. In this scenario, a drop in GDP in 2015 might be significant (down to 10%), but in the long-term things could become much better.
Second, a ‘forced’ monetary softening that presumes new massive liquidity injections. Under this scenario, GDP growth rate may fluctuate around zero for 2015. But an inflation-devaluation spiral and a gradual disorientation of financial markets will be inevitable. However, the fresh memories of an inflation-devaluation spiral in 2011-2012 makes this scenario less plausible.

Third, a massive increase in administrative controls, which includes control of prices, imports, employment, wages, etc. In the view of the authorities, direct price controls may neutralise further depreciation. Direct import controls may help compensate for export losses, etc. Direct control over wages and employment may also help Belarus avoid a sharp growth in unemployment.

For the short-term, this solution may be effective in the sense of mitigating a recession and the associated outcomes of well-being. This scenario may secure either near zero GDP growth or a modest decline (down to 3%). However, for in the long-term it also assumes huge risks, beginning with a more fragile financial system up to significant losses in growth potential. As of today, the government is hesitating on whether or not to proceed precisely with this option.

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