BELARUS

Highlights

- **GDP is growing again in 2017.** The economy shrank by 2.6 per cent in 2016 but in the first nine months of 2017 GDP grew by 1.7 per cent year-on-year, driven mainly by a recovery in external demand and the resulting growth in export-oriented manufacturing.
- **Macroeconomic stabilisation policies are bearing fruit.** So far in 2017, the exchange rate is stable and inflation is at its lowest level, reflecting a prudent fiscal and monetary policy stance as well as weak domestic demand. Transition to fully fledged inflation targeting has advanced.
- **The authorities prepared a comprehensive package of business liberalisation measures.** Changes are designed to lower barriers for engaging in private entrepreneurship and to minimise the administrative burden on businesses including through the enhanced provision of electronic public services.

Key priorities for 2018

- **Deeper structural adjustments are required to unlock growth potential.** Reforms should aim to overhaul the state enterprise sector and to phase out directed lending that misallocates financial resources away from the organically growing private sector.
- **Further reforms are needed in the energy sector and utility services.** The ongoing adjustment of utility tariffs should continue until full cost recovery has been attained. Efforts are required to increase the cost efficiency of winter heating for residential buildings to pave the way for full cost recovery in this area. Unbundling of the electricity sector is needed to attract private investment.
- **Remaining banking sector challenges should be addressed.** The banking sector should be fully discharged from performing quasi-fiscal functions. Preparation of some banks slated for privatisation, through corporatisation measures, institutional building and balance sheet sanitisation, should proceed without delay.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	1.0	1.7	-3.8	-2.6	1.5
Inflation (average)	18.3	18.1	13.5	11.8	8.0
Government balance[1]/GDP	-1.0	0.1	-2.2	-3.4	-5.6
Current account balance/GDP	-10.0	-6.6	-3.2	-3.5	-5.3
Net FDI/GDP [neg. sign = inflows]	-2.6	-2.3	-2.7	-2.4	-3.4
External debt/GDP	52.4	50.7	67.5	79.1	n.a.
Gross reserves/GDP	8.8	6.4	7.4	10.4	n.a.
Credit to private sector/GDP	20.3	21.1	23.1	21.3	n.a.

[1] Includes central government, local government and social security funds.

CONTINUES

Macroeconomic performance

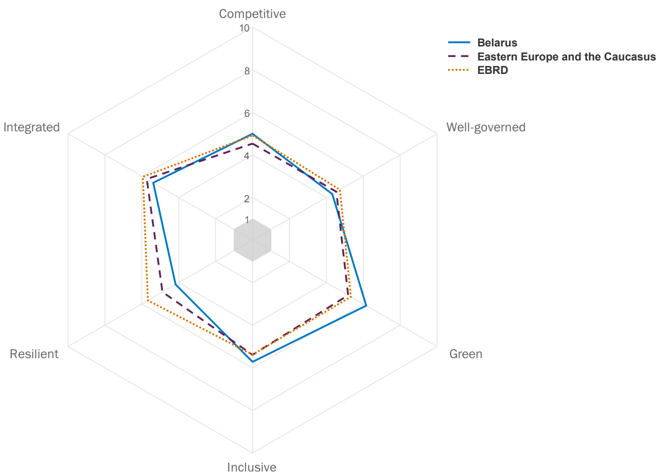
The economy is showing signs of recovery but structural bottlenecks to growth remain. GDP shrank by 2.6 per cent in 2016, the second year of recession in a row, with a broad-based output decline across major sectors of the economy. However, in the first nine months of 2017, the economy returned to low positive growth. GDP expanded by an estimated 1.7 per cent year-on-year in this period, driven by external demand and household consumption. Output in manufacturing, the economy's largest sector representing approximately 22.2 per cent of GDP, grew by 6.6 per cent year-on-year in the first nine months of 2017, mainly on the account of export-oriented industries, which are benefiting from the economic recovery in major trading partners. Agricultural output also demonstrated growth of 2.8 per cent year-on-year while construction contracted by 6.5 per cent year-on-year in the same period.

Inflation has fallen to its lowest level. Stabilisation of the exchange rate, weak domestic demand, moderation in wage growth as well as generally tight monetary and fiscal policies have helped to bring the inflation rate down to 4.9 per cent year-on-year in September 2017. This is significantly below the 9.0 per cent ceiling targeted by the National Bank of the Republic of Belarus (NBRB) in 2017, allowing for a gradual loosening of monetary policy. The refinancing rate decreased eight consecutive times in 2017 from 18.0 per cent in January to 11.0 per cent in October. Market interest rates have also declined.

The authorities made progress in unwinding macroeconomic imbalances although weaknesses remain. The exchange rate has been relatively stable since mid-2016. The current account deficit declined from 6.6 per cent of GDP in 2014 to 3.5 per cent in 2016 supported by devaluation in 2014-15 and a more flexible exchange rate regime. Proceeds from the issuance of sovereign Eurobonds in July 2017 and disbursements by the Eurasian Fund for Stability and Development (EFSD) helped to replenish foreign currency reserves. They increased to US$ 3.4 billion as of the beginning of October 2017 providing close to 1.5 months of imports coverage, which is still low relative to external liabilities. Despite the headline surpluses of the consolidated budget, the fiscal position is weakened by contingent liabilities arising from the high degree of state involvement in the economy and from directed and subsidised lending programmes.

Growth prospects depend on structural adjustments and the regional outlook. The near-term economic outlook has improved recently thanks to: (i) resolution of the gas price dispute with Russia and agreement to restore crude oil supplies to Belarus to ordinary annual volumes; (ii) resumption of disbursements by the EFSD and bilateral lending from Russia; and (iii) successful issuance by Belarus of dual-tranche sovereign Eurobonds for the aggregate principal amount of US$ 1.4 billion in June 2017. These developments have helped to mitigate short-term funding pressures. However, downside risks remain and the longer-term prospects continue to depend on the extent of structural reforms and on scaling back state interference in the economy.

Assessment of transition qualities (1-10)



CONTINUES

Major structural reform developments

Business deregulation initiatives aim to foster entrepreneurship. A comprehensive set of measures to cut "red tape" and ease administrative barriers for doing business was prepared and submitted to the President at the end of September 2017. The goal of the legislative package is to minimise the state's intervention in business activities. The package envisages, among other things, reform of the state's control functions; simplification of procedures for starting a business and conducting entrepreneurial activities in major areas of commerce; and a reduction in the number of licences and permits, as well as issuance of all licences in electronic form.

The state-dominated banking sector faces a backlog of problem assets. State-owned banks continued to dominate the market, accounting for around 65.0 per cent of sector assets at the end of the first quarter of 2017. The reported ratio of non-performing loans (NPLs) to total gross loans in the banking sector stood at 13.0 per cent as of 1 September 2017, up from 6.8 per cent at the beginning of 2016, but monitoring of the true level of problem loans is difficult due to directed and subsidised lending programmes which accounted for an estimated 40.0 per cent of all loans. The authorities have continued to reduce new directed lending, with its volume expected to decline from close to 5.0 per cent of GDP in 2013 to approximately 1.8 per cent of GDP in 2017 and an estimated 1.0 per cent of GDP in 2018. However, the stock of directed loans is expected to remain large in the medium term considering that it includes loans with long tenures and directed loans to corporates are often restructured due to their weak performance. The Development Bank of Republic of Belarus became the main administrator of directed lending programmes.

Monetary policy and regulatory frameworks are being gradually strengthened. Under the presidential decree issued in April 2017, the NBRB has switched from targeting exchange rate stability to price stability as the main monetary policy anchor. The authorities plan to move to a fully fledged inflation targeting regime by 2020. In May 2017, the NBRB adopted a resolution establishing a procedure for recognising banks as systemically important and introduced additional requirements for such banks to bolster capital buffers. The same resolution established Basel III liquidity ratios (liquidity coverage ratio and net stable funding ratio) as a functioning requirement for all banks and entitled the NBRB to apply countercyclical buffers if needed to mitigate excessive lending growth. This regulation is set to become effective from January 2018. To improve disclosure standards and transparency, from January 2017 the requirement to publish IFRS-compliant reporting has been extended to all companies whose securities are traded in a public market, banks, non-banking financial organisations and insurance companies.

Measures to prepare two state-owned banks for privatisation have advanced. Belinvestbank (BIB) made progress with commercialisation. The bank completed the inception phase of the institutional building programme in March 2017. New management was appointed and business processes were improved with the supervisory board assuming a more hands-on role. The clean-up of the balance sheet has advanced. By the end of 2016, a significant portion of the portfolio related to state programmes was transferred from the BIB's balance sheet, mostly to the Belarus Development Bank, and more of such assets are expected to be removed in 2017. Five non-core subsidiaries were divested. Meanwhile, Moscow-Minsk bank has focused on improving its commercial operations and broadening the client base as a first step towards attracting strategic investors.

Utility tariffs are adjusting gradually. As of the end of 2016, cost recovery for provision of all utilities reached an estimated 60.7 per cent. Gas, electricity, hot water and heating tariffs were further increased by an estimated 8.0 per cent as of 1 September 2017. Tariff increases have been supported by efforts to optimise costs related to generation of utility services. The pace of adjustment has been higher for utility services that allow consumption control by individual users, such as water and electricity. Raising district heating tariffs has been more challenging considering that the utilisation is centrally managed and that heating's existing cost recovery level is significantly lower compared with other utility services. The authorities introduced non-cash housing subsidies effective from October 2016 to mitigate the impact of tariff increases on vulnerable groups, that is, those whose spending on communal services is 20 per cent or more of their income in the city and 15 per cent or more of their income in rural areas.

CONTINUES

Disbursements by the EFSD advanced but programme negotiations with the IMF were put on hold. Following a brief hiatus, EFSD acknowledged that Belarus met most of the programme conditions and disbursed three tranches totalling US$ 800 million in the first 10 months of 2017. This brought total disbursements to US$ 1.4 billion out of US$ 2 billion allocated under the programme. Discussions between the IMF and Belarusian authorities about a possible programme have been under way since the beginning of 2015. More recently, the programme negotiations have stalled amid disparities related to the pace of utility tariff increases and the reform of the state enterprise sector.