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Global Economic Crisis and Belarus: A Look Back

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At first glance, it seems that Belarus' recent economic performance surprised most outside observers. According to official statistics, economic growth in Belarus between January and June 2009 amounted to a 0.3% increase year-on-year, while Russia's economy – a major market for Belarusian industrial exports – dropped by 10.1% year-on-year. Comparison of the country's previous economic performance illustrates the negative impact of the crisis. A decrease of external demand hit Belarusian industry and increased external imbalances, while the fall of energy prices and deterioration of enterprises deteriorated government revenues. All of these factors unveiled structural problems that required appropriate action. Instead, the government has chosen to delay "radical" reforms by borrowing abroad.

Loans as a solution

Belarus was among the first transition economies to ask for an International Monetary Fund (IMF) stand-by loan – "to facilitate an orderly adjustment to external shocks faced, and to address pressing vulnerabilities". Recently the IMF approved an additional loan increase of $1 billion, due to "a greater than expected impact from the global financial crisis on Belarus". As part of the loan agreement the Fund expects the Belarusian government to promote further liberalization efforts which includes preparing the economy for privatization, as well as implementing some structural changes deemed "essential to improve prospects for long-run growth and external stability".

Reforms as a remedy

At the moment, the shape of this "revised" economic program is not clear. However, the previous version, approved at the end of 2008, included several measures which can be viewed as improving liberalization efforts – including prices (partial), wages (minor), and doing business (quite progressive, but also partial). After recent discussions with the IMF and World Bank it seems that Belarusian authorities are ready to launch large scale privatization efforts. Evidently, all of these measures are good for growth in the medium to long- term, but the question remains will they solve the country's short-term economic problems?

Decrease of external demand

The rapid decrease of external demand in Belarus is a major consequence of the global economic crisis. It has two dimensions: 1) fall of oil and other commodity prices (which reduced windfall profits of Belarusian oil refineries and some other "output-generating" enterprises) and 2) decline of demand for industrial goods (tractors, trucks, refrigerators, etc). The first led to a decrease in the supply of foreign currency on the domestic foreign exchange market as well as contraction of government revenues. In 2008, two oil refineries were able to generate about 10% of general government revenues, however, in the first four months of 2009 consolidated revenues dropped to 47.8% of GDP. The decline in industrial demand resulted in increased inventories (finished goods in stock). According to official statistics, which are hardly reliable, 4.1% of industrial output produced between January and June 2009 has been directed into inventories. In some industries, like machine building, metal works and light industry it exceeded 10%.

As a result, between January and May of 2009, Belarusian merchandise exports dropped by 48% year-on-year. This is equally explained by a decline in average prices (which fell by about 30%) and volumes of exports (reduced by 25%). Taking into account the existing relationship between export and import volumes (1% change in exports leads to 0.64% change in imports), the contraction of Belarusian exports should result in a growing trade deficit.

In the first five months of 2009, the merchandise trade deficit amounted to $3.2 billion, or 17.9% of GDP. The first quarter's current account deficit amounted to $1.9 billion. Seasonally adjusted figures would be even higher. Usually, in the beginning of the year Belarus has more balanced external trade. Evidently, domestic demand has not followed export trends – in the first quarter, it increased by 7.3% year-on-year, mostly due to investment growth.

Behavior of domestic demand

Increased investment (by 17.6% year-on-year between January and June 2009) may seem quite unusual, especially during a major economic crisis. However, a major source of investment in Belarus came from a rise in bank loans. These banks disposed government funds (as it was in the end of 2008) and loans obtained from the National Bank (NBB). Between January and May, NBB's claims on banks increased by 115.2%, while reserve money for this period shrank by 21.1%.

Active refinancing of banks seems contradictory to other elements of monetary policy (increased interest rates on NBB's instruments and sterilization of net foreign assets increase). However, it can be easily explained by the fact that the government, in order to get the IMF's loan, made an obligation to run balanced budgets and transfer deposits in commercial banks to the NBB. This reduced the government's ability to stimulate the economy via usual sources and "forced" it to increase the money supply through the above mentioned channel.

In addition, consumption has also increased (by 5.5% year-on-year in the first quarter). The main reason behind its growth was inertia, because the government preferred to freeze incomes (or, more precisely, to restrict their growth according to the IMF agreement). However, this freeze was not enough to reduce imports to the extent necessary to balance external trade. As a result, in the first five months the value of imports dropped by 33.3% year-on-year.

Policies that followed: Devaluation and exchange rate band

Growing external imbalances forced the government to revise exchange rate policy. First, the NBB switched from a US Dollar peg to a currency basket (Euro, US Dollar, and Russian Ruble in equal weights) with a ±5% currency band. Second, the Belarusian ruble was devalued by 20.45% on January 2, 2009. The devaluation was required by the IMF. Despite the measure, this devaluation has not been followed by a restriction in domestic demand, thus the current account deficit persists. Additionally, households responded to the ruble's depreciation with expectations of further devaluation, resulting in higher demand for foreign currency. Dollarization of broad money increased from 33% (as of January 1, 2009) to 46.3 (as of June 1, 2009). Therefore, the value of the currency basket approached the upper bound of the currency band, and on June 22, 2009 the NBB announced a widening of the exchange rate band to ±10% (which was highly supported by the IMF). In any case, the main reason for exchange rate instability – the current account deficit – persists, requiring swift and adequate policy action by Belarusian authorities.

Forecasting the current account deficit

The IPM-CASE Research Center in Minsk developed a macroeconometric model, which can be used for macroeconomic forecasts. On its basis, several scenarios of economic development influenced by the global economic crisis have been modeled. According to the scenario that assumes no further devaluation (and quite moderate recession in Russia and the Eurozone) the current account deficit reaches $6.4 billion in 2009 and $8.2 billion in 2010. Further estimates show that under current income and monetary policy, even an additional one-time 40% devaluation would lead to only a moderate reduction of the deficit (from $4.9 billion in 2009 and $5.4 billion in 2010). Hence, according to the model, tighter monetary and income policies are crucial for external stability.

Social issues

Another important policy challenge facing Belarus relates to the social consequences of the crisis. Prior to, Belarus demonstrated impressive results in reducing absolute poverty from 46.7% in 1999 to 6.1% in 2008. This reduction originated from more equal distribution of the fruits of economic growth, macroeconomic stability and high employment. All of these determinants have faded out (economic growth) or are under current threat (high employment). The potential increase of poverty creates challenges for social policy, due to a drastic fall of government revenues and poor identification of highly vulnerable groups, especially unemployed and low-paid workers.

The main "social" choice for the government is between hidden and open unemployment. Hidden unemployment (current choice) allows postponement in reform of the employment promotion system, but requires subsidies to loss-making enterprises and conservation of inefficient production. Open unemployment allows cuts in production costs, but requires social assistance reform. Efficient privatization is another possible solution, although it would require firing excess labor. It would create new work places and generate revenues for social support.

Concluding remarks

The global economic crisis seriously affected Belarus, primarily through declining demand for Belarusian exports. Unfortunately, government reaction has not lead to external adjustment as it has tried to smooth the impact of the crisis with external borrowing. However, reducing Belarus' substantial current account deficit can only succeed through a combination of tight monetary and fiscal policies. If market adaptation mechanisms are further restrained, devaluation may be inevitable.

Reacting adequately to the global crisis requires structural reforms, as prior domestic demand-enhancing policies are limited due to the drastic fall (about 10% of GDP) of general government revenues. Social security reform is another challenge. Conditional borrowing brings some hope for these reforms – but only if Belarus is a true miracle, where conditionality works perfectly.

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