Belarus Economy Monitor: trends, attitudes and expectations

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Abstract

- ECONOMIC GROWTH ENVIRONMENT REMAINS WEAK

Near-future economic growth prospects will depend on exports increase capacity. However, as a wave of uncertainty will come into play due to the effects of sanctions, narrowing opportunities to attract resources from foreign markets, questionable stability in the region, and potential internal and external shocks, one should not expect this year to be as successful as the last year.

- ECONOMIC MIGRATION TENDS TO INCREASE. WAGE GAP, IF COMPARED TO WAGES IN NEIGHBORING COUNTRIES, KEEPS GROWING

Not everyone was able to enjoy successful economy in 2021, which is clearly visible in the difference in the average wage growth: while wages in the production sector increased by 9.5% in real terms, wages in the construction sector remained unchanged, and wages in the IT-sector decreased by 5.3%. In general, the average wage gap between Belarus and some of its neighbors has increased, which may trigger a more intense economic migration. Experts do not project a significant increase in real wages this year, and if sanctions are in force, experts forecast a slight decline.

- INFLATION RISKS REMAIN ELEVATED

The external environment created favorable conditions for a sharp increase in exports of Belarusian products and the ability to raise their prices. At the same time, the global price rise has also affected the Belarusian market. However, it was not the only reason: pressure on prices was exerted by the expected inflation, which was 14.2% in December. The desire to regulate prices has not been not left aside: despite the measures taken, regulated prices and tariffs rose by 9% in annual terms in December 2021. Global inflation slowdown will affect the inflation slowdown in Belarus this year, but inflation expectations, higher taxes and rates will cause a price growth inside the country. As a result, inflation at the end of the year may get close to 10% again.

The Expert Opinion Bulletin (as part of the project titled Monitoring of the Belarusian Economy: Trends, Attitudes, Expectations) presents a subjective expert review of the key short-term trends in the Belarusian economy. Each bulletin issue will select three key trends based on a survey of three experts: two BEROC staff members and one external expert. The summary captures these trends, as well as the expectations of the three experts interviewed for future economic dynamics. The body of the bulletin provides individual expert opinions on one of the challenges, their expectations and situation development scenarios.

Country loses development opportunities

A Russian economist specialized in the banking sector and in studies of the economies of the EAEU countries. He agreed to provide his analysis on condition of anonymity.

Factors that affected economic growth in 2021

In 2020, due to the lack of restrictive measures, the Belarusian economy sagged less compared to other countries, but it grew more slowly in 2021 because it was not affected by the low-base effect. E.g., Belarusian GDP grew by 2.3% in 2021. And Russian GDP, according to preliminary data, grew by 4.5%, i.e. it was almost twice as high. However, by 2019, Belarus grew by 1.6%, and Russia grew by 1.7%. It turns out that in the two-year period the growth was about the same.

Extremely favorable global market conditions played a key role in last year's growth, and exports were the predominant growth driver. Prices for Belarusian export goods grew more slowly than those for imported goods in early 2021. However, due to the extremely favorable pricing situation on global markets, which started in the middle of the year, the trend changed: export prices moved to a steady growth, exceeding the increase in import prices. Thanks to this, even businesses under sanctions could cover their overheads.

Commodity prices on the world market rose off the charts. The most striking case was nitrogen fertilizers getting more expensive exponentially following the growing natural gas prices. Although, the potash price was quite stable at the same time. And since the natural gas price did not change for Belarusian companies, they enjoyed this competitive advantage.

Food and wood products also rose in price at a record pace, ensuring a forex earnings increase.

The GDP growth slowed down in the second half of last year. The minimum pace was in October, when it neared zero. And the GDP growth accelerated slightly in the last two months of the year: it was 1.3% in November, and even 2.3% in December. Another of the two main growth drivers was the export of IT-services, which by the end of the year noticeably exceeded $4 billion (another historical record for the Belarusian Hi-Tech Park (HTP)): it accounted for about a third of the real GDP growth.

A fairly rapid growth of the industry related to oil refining and the production of potash fertilizers was largely due to the low-base effect: oil refining experienced challenges due to the Russian oil supplies and pricing disputes in early 2020, Belaruskali was waiting for two major contracts to be concluded. Therefore, these sectors had a very rapid growth in early 2021. As Naftan and Belaruskali found themselves under sanctions, data on these sectors ceased to be disclosed, but one can appreciate the dynamics of the sectors by subtracting the output data of the rest of the manufacturing industries from the total output data. Such an “aggregate” industrial sector showed rapid growth in the first half of 2021; and in the second half of the year, the pace went into the red or was close to zero. However, this negative effect of the sanctions was outweighed by a favorable market situation. Some manufacturing industries performed very well in 2021: computer and electronic equipment production grew by 20.3%, woodworking grew by 12.2%, and the pharmaceutical industry grew by 9.8%.

Due to a significant drop in investment throughout the year, the anti-driver was the construction sector: its decline offset all the growth provided by the IT sector. At the very end of the year, the industry seemed to revive a bit, but one cannot say this is a sign of a turning trend.

Consumption grew slowly (with the exception of the second quarter, which was affected by the low-base effect) amid a slowdown in real income growth and stagnant consumer lending. In general, people have become quite conservative in their consumer behavior: December calculations show low consumer confidence. Therefore, it is too early to say people are ready to maintain current consumption hoping for future income growth as it was, for example, in late 2016.

Near future outlook is uncertain

In fact, growth prospects now depend largely on the ability to increase exports.

On the one hand, sanctions continue affecting. This applies both to the rising logistics and legal support costs and the overall negative image of the country in the eyes of its counterparties due to the current sanctions and the continuing risks of their expansion.

On the other hand, attracting foreign financial resources is rather challenged still. If there are negative shocks, Belarus will have no sources of financing other than Russia. This is an additional uncertainty since large loans (interstate loans and EFSD funds) are raised on the basis of political agreements at the highest level. Commercial banks and businesses can use market instruments still, but the terms and conditions for raising such funds have deteriorated significantly compared to the pre-sanction times.

Domestic sources of financing are challenged, too. The Ministry of Finance had planned a large deficit for 2021 (over 6.5 billion Belarusian rubles), but in the end, according to preliminary data, the budget of public authorities was executed with a surplus. It is difficult for the Ministry of Finance to attract even Belarusian rubles. The Ministry of Finance could probably place short-term Belarusian ruble bonds, but there are no long-term resources available on the market today. The National Bank (central bank) may not finance the budget deficit through money issuance either (it is prohibited by law).

Under such conditions, the Ministry of Finance is forced to continue pursuing a very conservative fiscal policy and limit spending. First of all, this refers to national spending, i.e., the State Investment Program. And this creates additional constraints to economic growth.

At first glance, it seems that the situation at the end of the year was pretty good: growth was higher than expected; forex rates were quite stable; people stopped recalling their bank deposits; the inflation rate — although it reached 10% — was not much different from inflation rates in the neighboring countries. However, the outlook is uncertain.

The National Bank, as a regulator, has very few options to influence the situation, especially the options that would allow the banking system to operate as an effective channel to finance investments. There was excess liquidity in the banking system almost throughout the year, i.e., banks preferred not to expand their loan portfolio and kept their free money in the National Bank. Why is this happening? If banks attract short-time resources, it is too risky to offer investment (long-term) loans leveraging these resources. Therefore, there are risks not only for banks, but for the economy, too. Recall the times of Pyotr PROKOPOVICH (ex-head of the central bank), when the National Bank would permanently refinance banks or one may recall when the Ministry of Finance placed its resources in banks so that banks could provide preferential lending to state programs. If this practice were to be reintroduced again (so far, it is difficult to do as the Ministry of Finance has no spare resources and the National Bank may not refinance banks for long periods by law), it would quickly lead to the same consequences as in 2008, 2011 or 2014, when Belarusian rubles would quickly penetrate the forex market making national currency devaluation inevitable. Consequently, GDP would fall in the USD equivalent, and the relative performance of public debt (public debt to GDP) would deteriorate. This could end up in a revision of the sovereign credit rating, a drop in the value of government securities, and quite dire consequences for the banking sector. To understand this, one might recall how the recent fall in Russian securities quotes hit the capital of Russian banks.

It is evident that the situation is rather fragile. The Government, the National Bank, businesses and the banking sector are in a very tight framework; therefore, any external or internal shock can unbalance the situation, and it will be very difficult to control it.

Economy growth factors

The key factor that will influence economic growth is preserved stability in the region. In particular, there is the risk of a conflict or something else to be followed by harsh sanctions against Russia. This is because the Belarusian economy has never been as tied to the Russian economy as it is today. It has come to the point when Russian economy is virtually the only source of resources, the predominant market, and the region with logistical opportunities for exports of a number of domestic goods. This means that any negative shocks affecting Russia will affect the Belarusian economy to an even greater extent.

The second factor is domestic. The key issue is the demand (consumer confidence) and investments associated with the extent to which people identify their future with the country's future. A recent study by BEROC (Kiev, Ukraine) has shown that consumer confidence in the future is negative: people perceive downside risks as high; therefore, they do not increase consumption. Investors do the same. As a result, the country misses development opportunities.

Political migration will be followed by economic migration, because wages are rising, but the wage gap with the neighboring countries is widening

Katerina Bornukova, Academic Director, BEROC (Kyiv, Ukraine)

Salaries continue rising

The main trend in the labor market has traditionally been the growth of wages. It was uneven last year: wages grew faster in some industries and slower in others, and in some sectors wages in real terms did not increase at all. In nominal terms, wage growth averaged 13.6% at the end of December 2021, and it was a significant increase. Unfortunately, most of the growth was eaten up by inflation.

The real wage growth in December 2021 compared to December 2020 was only 2.7%. As GDP grows and employment shrinks, this growth in wages can be considered quite modest. E.g., in 2019, GDP growth was 1.4% and real wages increased by 6.5%; in 2017, the economy grew by 2.5% and wages in real terms grew by 7.5%. Even in 2020, when GDP declined by 0.7%, wage growth was 8.8%.

On the other hand, there was an increase in forex terms (the dimension liked by Belarusians). If you recalculate the average salary in US dollars, then thanks to favorable external conditions and the strengthening of the Belarusian ruble, it once again crossed the "magic" bar of $500 and entrenched significantly higher. E.g., the average salary was equivalent to 580 US dollars in November, and it was even 660 US dollars in December (but annual bonuses are traditionally paid in December).

However, not everyone felt this growth. While the growth of the average wage was 9.5% in real terms in production industry and it reached 15% in some subsectors, the average wage in the construction sector did not change. Oddly enough, the average wage decreased by 5.3% in the Information and Communications (ITC) sector. This was primarily due to the strengthening of the Belarusian ruble, because salaries in the IT sector are pegged to USD. In addition, relocation of the most highly paid experts of the sector could have an impact. I.e., many senior software engineers migrated, and the employment rate in this sector has grown due to newcomers with lower wages.

There was no increase in real wages for state employees at all. Real wages remained unchanged in the education sector, but in the health sector, on the contrary, there was the average wage decline of 12.9%. This was primarily because of the reduced COVID-19 premiums paid to health workers.

Therefore, not everyone was able to enjoy the growth of the economy in 2021.

New trend: growing economy, but shrinking employment

Despite good economic conditions, employment decreased by 50,000 people (over 1% of the employed) in Belarus. In general, reducing employment is quite typical for the Belarusian economy due to population aging. However, this process would usually slow down in years of rapid growth or crisis recovery. This was the case in 2017-2018. Declining employment amid GDP growth is a surprising economic fact. Most likely, it is explained not only by economic factors, such as a negative growth of the construction sector leading to decreasing wages and employment, but also partly by political reasons, primarily migration.

This is an important trend because spikes in visible migration create network effects. Today, many Belarusians know that their fellow citizens are actively migrating, and Mass Media keep publishing articles about how people have settled in other places. All this removes a certain mental barrier to migration. People have started to understand how to relocate and what they should do to migrate. Moreover, they are aware that the established migration networks will help them if they migrate even if this help is just advisory.

Given that the average wage gap between Belarus and Poland (and Ukraine and Russia as far as many sectors are concerned) increased even in this good year (good in economic terms), it is likely that political migration will be followed by economic migration. This will be a big challenge for the country with an aging population.

Dismissals for political reasons are invisible at macro level

There was information published about 300 workers in the culture sector fired for political reasons in January. There are occasional reports of layoffs in other sectors. However, this process has not reached such a scale as to affect the overall employment rate. I.e., it is visible neither as a negative dynamic in the markets nor as a deteriorating employment structure, nor as polling outcomes. It is indicative that a recent BEROC (Kiev, Ukraine) survey has shown that the percentage of people who referred to their layoffs was low and matched the economic reality, while the percentage of those who referred to the layoffs of somebody they knew was the highest in the last two years of BEROC's monitoring. This indirectly indicates the visibility of high-profile layoffs. After all, current layoffs of rank-and-file employees may get invisible, but if a chief engineer at your plant is fired, you'll definitely know about this.

Such layoffs, while invisible at the macro level, rather affect productivity because they are often about sectoral leaders and skilled professionals. This has been seen in factories firing valuable specialists and long-posting job vacancies to occupy these positions.

While public sector benefited from the export "miracle", pessimism reigns in the private sector

In 2020, thanks to government support, one could see that state-owned enterprises did not lay off actively, and they even increased the share of people who worked for them. I.e., the percentage of those employed by state-owned enterprises increased and decreased at private enterprises. This is not surprising, because it was the private sector that was hit by the COVID-19 pandemic the most, while state-owned enterprises were supported by the government.

2021 was a successful year and did not require direct administrative government interventions in the economy. However, the growth was driven by sectoral movements. Given the specifics of last year's economic growth (export-oriented sectors were key contributors), employment grew primarily in the sectors that benefited the most from the export boom. It can be assumed that the public sector grew more actively than the private sector, because the main industrial exporters are owned by the state. This means that the share of the public sector in employment in the economy has also increased in general.

Today, the peculiarity of the private sector is that it is dominated by pessimistic views of the future. Business surveys have been showing that the representatives of private companies point out high risks and uncertainty. Having such sentiments, it is inevitable that new projects and investments will curtail. This indicates that the private sector hired less last year and will continue employing more slowly this year than it did in the past. A couple of years ago one could see a steady growth trend in the role of the private sector in the labor market in Belarus; and now, this process will suspend if not reverse.

Sanctions will become challenging for the economy of the country's regions

The effect of sanctions on the labor market is not yet noticeable. It has not been felt much even economically because most sanctions are deferred actions. If one looks at the restrictions that have already come into force (e.g., against Belarusian airlines), one can see that the air cargo market has suffered the most. And there was no such a negative effect on the passenger air transportation. Passenger air transportation was helped by changing destinations and, possibly, by the flows of migrants coming to Belarus. It's worth noting, though, that the restrictions were enacted after 2020, a year when air travel was already severely affected, impacting both employment and wages in the sector. I.e., they had fired everyone they could, and salaries in the sector had been cut before the restrictions were enacted.

It is impossible to see the impact of sanctions on the KPIs of some other sectors, because the statistics for these sectors are no longer disclosed. However, one can see that employment has been growing in oil refining, as well as in chemical production. This proves that the effect of sanctions is not yet visible in these sectors. However, one needs to understand that restrictive measures were not enacted last year.

Nevertheless, as the sanctions become effective, they will become a certain challenge, because the enterprises to be affected by the sanctions (in particular, two major oil refineries and Belaruskali) are situated in relatively small towns, and these are backbone enterprises. This means that the salaries of their employees constitute the main purchasing power of the residents of these settlements and set the pace to other local businesses. If, once the sanctions are effective, the affected enterprises cut jobs or salaries (they will have to choose among these options despite government support), this will significantly affect local economies.

The government is apparently going to mitigate the impact of sanctions as much as possible, inspired by the way the pandemic's effects were mitigated in 2020. However, it's important to consider that the restrictions will hit differently, not like the COVID-19 shock, which actually occurred in the second quarter of 2020, after which things leveled off. If nothing changes, sanctions are a long-term issue. Under such circumstances, if Belarus is able to sell, let's say, only half of the extracted potash, it won't be able to employ the same number of miners with the same salary as before. Moreover, restrictive measures will affect the sectors associated with the sectors under restrictions. Take, for example, the Belarusian Railway, which is one of the largest employers. If potassium transportation is seized, this will affect the labor market not in a single city, but throughout the country.

Near future labor market forecast

People who will lose their jobs due to sanctions or other reasons will emigrate. This phenomenon can hardly be a novelty for Belarus, because the country has previously "exported" Belarusians when in crisis. People would move to Russia more often; and today, due to the network effect of migration, the migration geography may expand.

Since some people will leave the country searching for employment, Belarus is unlikely to face a large increase in unemployment. Some increase, if any, will be localized in the towns where enterprises will be directly affected by sanctions.

At the same time, real wage growth is not expected this year. And if sanctions are enacted, then even a slight decline can be expected. However, a decline in real wages by 2-3% on average will mean that some will see a 10-20% decrease in their salaries.

Reasons for inflation surge are excessive love for regulation, distrust, plus a global trend

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Inflation as a global trend in 2021

Accelerated inflation was one of the most notable economic outcomes of 2021. In a year of recovering global economic activity, it reached 6.8% in the US, 5% in the EU, and 8.39% in Russia. The main reason for this inflation surge was that developed and many developing countries wanting to support their economies while they were put into an artificial coma during the COVID-19 pandemic, took unprecedented support measures. These were large-scale interventions, the issuance of money; states sometimes literally handed out cash to people and companies alike.

At the same time, people, unable to spend money on almost anything but food, increased their savings. Therefore, people spent more on food, and the savings were actively invested, for example, in housing. This spurred the rise in food prices and everything to do with construction. In particular, global timber prices almost quadrupled in 2021, in part because the middle class in the EU and the US (and the rich Chinese along with them) saved well in 2020 and started investing in real estate and construction, and the world economy could not increase the production of timber at the same rate as the demand for it grew.

Once restrictions were lifted, countries started recovering from the crisis rather quickly, surpassing experts' forecasts. Governments and central banks were still hesitant to completely curtail economic stimulus programs, being unsure whether the world was out of the pandemic economically.

On top of that, many regions were unlucky with crop yields in 2021, which also pushed up food prices. During the same period, the prices of transport services increased markedly, which also affected the final cost of food, products, and goods.

High world prices could not but echo in Belarus. On the one hand, the impact of high prices was positive: prices of some export commodities increased heavily, which caused an "export miracle". On the other hand, being a small open economy, Belarus absorbed some of this global inflation.

Some Belarusian peculiarities added to the global trend

The first one is distrust, which inevitably leads to accelerated price growth. The Consumer Price Index is closely related to anticipated inflation. In this case, the self-fulfilling prophecy mechanism translates the anticipated inflation into a real one. Suppose an entrepreneur enters into a contract to sell some products for a year. If the entrepreneur thinks that inflation will be 20% for example, then s/he stipulates in the contract that in a year's time the buyer will pay 20% more. If the buyer also anticipates the same increase in prices, it will not consider this condition crazy and will agree to conclude such a contract. This is one example, but if many in the society share the idea that there will be a 20% increase in prices, then the increase in prices will turn out to be about 20% in the end.

Thus, trust in public institutions, including central banks, undermines during political crises. And anticipated inflation grows in such an environment. This is exactly what is happening in Belarus. In 2021, official inflation was 9.97% in annual terms. According to the National Bank, anticipated inflation amounted to 14.2% in December. By comparison, it was 11.7% in August 2020 and 10.6% in May 2020. It is seen that expectations of inflation are rising. They are also pushing its actual growth.

The second peculiarity is the state's excessive love for regulation. Public offices continue sharing somewhat Soviet mechanistic vision of the economy: if prices are high in stores, stores must to be ordered to lower prices. However, history proves real price regulation can lead to shortages of goods. Such an outcome would be too awkward in the 21st century. To prevent this, one has to go for tricks, which, no matter how hard one tries, still lead to higher prices. The Ministry of Antimonopoly Regulation and Trade (MART) regulated prices of a large number of consumer goods last year, allowing them to rise to a certain limit from time to time. Price increases were allowed when there was "an objective situation with an increase in global prices." In such a case, the retailer fearing future losses will raise prices by the maximum allowed rate then.

Due to such measures, Belarus is among the countries that try to curb prices, but still face price increases. In December 2021, regulated prices and tariffs rose by 9% year-over-year.

At the same time, to compensate for risks and possible losses, businesses increase prices of their products that are not subject to regulation. As a result, prices continue rising. In December 2021, core inflation was 9.8% in annual terms. It was 7.1% a year earlier, and it was 4.3% in August 2020.

One striking example of how the prices of regulated goods increase is fuel. In contrast to Kazakhstan, where authorities recently tried to raise fuel prices dramatically, Belarus has been operating its scheme for years: fuel prices rise by one kopeck ($0.0038) only, but with enviable regularity. The process is almost imperceptible, but as a result, fuel prices were at the top of the price-risers (as far as regulated prices are concerned) in December 2021: fuel prices grew by 17.1% in annual terms. And fuel is a special product: its price is embedded in the prices of most goods transported to warehouses and then to retail outlets. Therefore, a fuel price increase affects the prices of other products.

Another factor is related to crop yields: 2021 was not the best year for agriculture in Belarus, either. Yields of major crops were lower than in the two previous years. As a result, agricultural producer prices increased by 18.7% over the year.

Sanctions and counter-sanctions did not affect prices meaningfully

European sanctions did not affect the disposable income of Belarusians last year. First, this is because the announced restrictions are not in effect de facto yet for most items. Second, the restrictions had nothing to do with the consumer basket, prima facie.

The counter-sanctions adopted by the Belarusian authorities in January 2022 affect about 1% of imports. The percentage is higher for fruits, vegetables and nuts, as well as confectionery. Belarus is self-sufficient as other foods are concerned. If some food may not be delivered from Germany, it will be brought from Turkey at a slightly higher price. This will hardly affect the average consumer basket.

Problems at the state border causing longer transportation times may have contributed to a minor price increase. But even in the case, this contribution to consumer inflation was probably small.

Near future expectations

The outstanding question: what will happen to global inflation and will it continue affecting Belarus? The world's largest central banks believe this is a temporary thing, and they will easily overcome high inflation; and markets in general also expect that global regulators will address inflation by raising key rates. In any case, this is provided for in baseline forecasts. If global inflation really slows down, it will start reducing inflation in Belarus.

As for domestic factors, inflation expectations will remain high in the near future, continuing to spur price growth. Additional inflationary pressure will come from tax increases, although almost all secondary taxes have already increased in the past two years. The fact is that a significant part of retail trade in Belarus is associated with individual entrepreneurs (IEs). This year, those IEs who will not go bankrupt due to changes in the Tax Code will shift their additional tax costs to the final prices of products.

Given that MART wants to resort to slightly more liberal mechanisms and softer price regulation, if these plans are implemented, trade will stop raising prices in advance some time after. However, this is only possible after a clear signal that the government is not going to repeat last year's actions in the future. So far, authorities keep sending opposite signals. In particular, Alexander LUKASHENKO recalls from time to time that inflation is not a monetary phenomenon, but prices rise because of the “retailers’ greed,” and “something needs to be done about it.”

In addition, an important factor is that the National Bank of Belarus is still trying to refrain from running its money printing press, although there have been a couple of cases of directed lending in recent years. In the future, however, there are serious chances that the National Bank will be under pressure, as a result of which part of the new investment cycle will fueled by unsecured issuance of money since it will not be possible to borrow on market terms.

Nevertheless, even if there is a favorable foreign environment and even if measures are taken to curb price increases, the inflation rate of 6% projected for this year is likely to get higher. Given the fall in global inflation, it is very likely that Belarus will manage to maintain its inflation below 10%, and if the Belarusian economy slows down, there is a chance to keep it around 7-8%.