EFSD Eurasian Fund for Stabilization and Development

Republic of Belarus

Social and Economic Development in 2021*

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EXECUTIVE SUMMARY

In 2021, the key driver of Belarus' economic growth of 2.3% was high external demand attributable to the global economic recovery. Business activity was also supported by stronger household consumption against the background of delayed demand of the previous year and continued growth of real incomes of the population, despite a significant contraction of consumer lending. At the same time, the high uncertainty of the business environment, against the backdrop of sanctions, resulted in markedly subdued investment activity. However, the economic sanctions imposed during the year by a number of Western countries and the United States had a limited impact on foreign trade as they mostly applied only to new contracts.

The recovery of the economic growth in the Republic of Belarus in 2021 contributed to a significant improvement of the fiscal performance and a decrease in the public debt. At the same time, the acceleration of inflation to 10% in 2021 was mainly associated with the impact of non-monetary factors driven by higher external inflation and continuing logistics difficulties in the supply of certain goods.

REPUBLIC OF BELARUS: SOCIAL AND ECONOMIC DEVELOPMENT IN 2021

Real Sector and Labour Market

The key driver of Belarus' economic growth in 2021 was external demand in the context of the economic recovery of its trading partners. In 2021, the real GDP growth of 2.3% was mainly driven by net exports of goods and services (a contribution of 2.6 p.p.). Another growth driver was consumption, primarily private consumption (+1.6 p.p.), which—despite a significant contraction of consumer lending by 5.6%—was supported by an increase in real disposable incomes of the population by 2.0% (Figure 1).

The growing uncertainty of the business environment and constrained borrowing in the context of sanctions weighed in on the formation of negative contributions of private and public investments to the GDP of -1.5 p.p. and -0.7 p.p., respectively. Capital investments dropped by 5.6% compared to the corresponding period of the previous year (against a decrease by 6% a year earlier). Investments in construction and installation work contracted most markedly (-12.2%), while there was a slight increase in spending on purchasing machinery, equipment, and vehicles (+3.9%). The most notable decline was registered for budget-funded investments (-15.2% and -15.5% for the republican and local budgets, respectively), including project-related loans, as well as bank lending for investment needs (-12.8%).

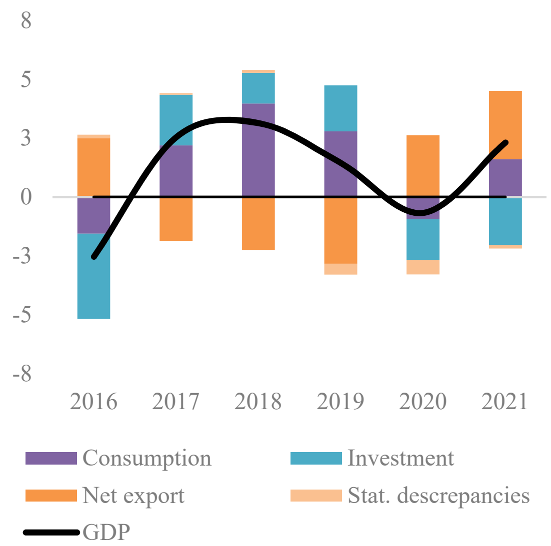
In terms of sectors, the most significant contribution to the economic growth was that of industry (+1.7 p.p.), information and communication (+0.8 p.p.), as well as trade (+0.4 p.p.) (Figure 2). The growth of industry (+6.6%) was largely driven by high external demand attributable to the economic recovery of Belarus' key trading partners, as well as the effect of a low base of refined petroleum and chemical product output in 2020. In addition, the inventories of manufacturing products declined to 60.2% of the average monthly output against 75.7% a year earlier. Construction and agriculture contributed negatively to the real GDP growth (-0.7 p.p. and -0.4 p.p., respectively). The drop in agricultural output (-4.8%) was driven by a poor harvest of vegetables (-11.7%) and cereals (-15.7%) due to adverse weather conditions, as well as lower production (rearing) of livestock and poultry (-2.8%). The developments in construction (-12.2%) were largely driven by weak investment activity.

The high rates of economic growth had a limited effect on the labour market. The unemployment rate[1] improved slightly, decreasing to 3.9% from 4.0% a year earlier. The number of employed persons continued to decline, while the rate of its decline accelerated marginally. In 2021, the average annual number of employed persons decreased by 0.9% against a decline by 0.3% a year earlier. The largest drop in employment was observed in construction (-8.2%) and agriculture (-3.4%), which accounted for more than half of the decline in the total number of employed persons. The employee replacement rate[2] was 0.90 in 2021 against 0.93 a year earlier, which is explained by the rate of growth of the number of dismissed employees (+3.7%) above that of hired employees (+0.3%). The decrease in employment may indicate a decline in the active labour force associated with the retirement of some employees and outward labour migration from the Republic of Belarus.

Real wages increased by 4.4% in 2021 compared to 8.2% a year earlier[3]. The highest growth rates of real wages were observed in industry (+6.8%), healthcare (+6.0%), and transport (+5.2%).

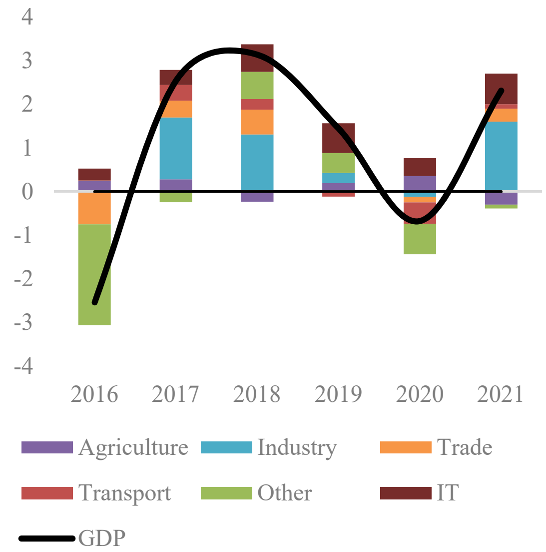
[1] According to a household sample survey based on the ILO criteria.
[2] The ratio of the number of hired employees to that of dismissed employees.
[3] The high rates of wage growth in 2020 were driven by the introduction of salary increments for health workers in the context of the pandemic, as well as growth of wages in the IT sector against the background of BYN depreciation.

Figure 1. *Contribution to GDP growth, by expenditure components (p.p., y-o-y)*



Source: Belstat

Figure 2. *Contribution to GDP growth, by production components (p.p., y-o-y)*



Source: Belstat

Inflation and Monetary Policy

Inflation continued to accelerate in 2021. It was driven by mounting external inflationary pressures, a poor harvest, persistent global logistics constraints, and rising inflation expectations. Consumer prices increased by 10.0% in annual terms in 2021 compared to 7.4% a year earlier and the National Bank's target of no more than 5% (Figure 3). The core inflation for the same period increased from 7.1% to 9.8%. In terms of consumer market segments, the main contribution (+5.0 p.p.) to higher consumer prices in 2021 was generated by rising food prices (11.4%) against the background of world food price growth, as well as a poor harvest in the country. The strongest price growth was observed for fruit and vegetables, meat and meat products, as well as confectionery products. There was also a marked acceleration of the price growth in the segment of non-food products, which amounted to 9.9% against 8.1% a year earlier—a contribution of 3.2 p.p. against 2.6 p.p. a year earlier. An additional inflation factor was the growth of fuel prices (+17.1%) in the domestic market driven by the behaviour of the world oil price.

The unfavourable price trends, largely driven by non-monetary factors, in particular higher external inflation and persistent logistics constraints, led to a marked increase in inflation expectations. According to the National Bank, the inflation rate expected by the population in December 2021 was 14.2% in annual terms against 11.3% in November 2020.

In 2021, the monetary policy was aimed at balancing support to the economy and ensuring price and financial stability. However, while in the first half of 2021, the actions of the National Bank were aimed more at limiting the money supply to curb the inflation, the monetary conditions eased starting from the second half of the year, despite the still heightened inflation.

In March 2021, the temporary decision to suspend the standing facilities of liquidity support and sterilisation, adopted in August 2020, became open-ended. The volume of liquidity provided by the National Bank through auctions, mainly under 180-day transactions, was substantially limited. The National Bank raised the refinancing rate from 7.75% to 9.25% per annum (two increases by 0.75 p.p. in April and July 2021). Nevertheless, it remained negative in real terms throughout the year. In addition, the estimated values of standard risk[4] (EVSR) for new

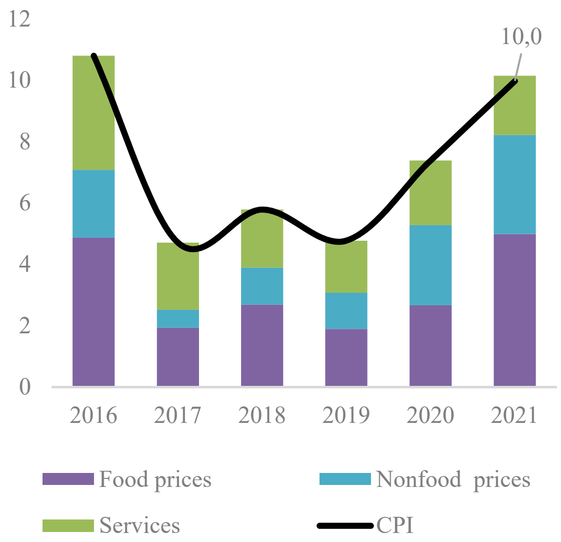
[4] The EVSR is a macroprudential tool aimed at limiting the business models of banks with heightened risk appetite. The risk indicator used is calculated based on average interest rates of Group I banks of systemic importance, taking into account a measure of the interest rate variation.

bank loans increased for legal entities and private individuals, respectively, from 11.8% to 15.8% per annum and from 13.3% to 20.6% per annum in 2021. Much of the EVSR growth occurred in Q1–Q3 2021.

High external demand and growing foreign exchange earnings contributed to BYN appreciation, which, according to the estimates of the National Bank of the Republic of Belarus[5], led to a reduction of its undervaluation. Starting from the second half of the year, the National Bank was actively purchasing foreign exchange in the domestic market and expanded the provision of liquidity to banks through substandard operations on a bilateral basis. It resulted in excess short-term liquidity in the banking system, and the National Bank began its sterilisation in limited amounts only in October 2021. In that context, the average short-term market interest rate dropped to 1.0% per annum in December 2021 (against 6.2% a year earlier) and the average interest rate for new term deposits went down to 7.3% per annum (against 13.2% per annum a year earlier).

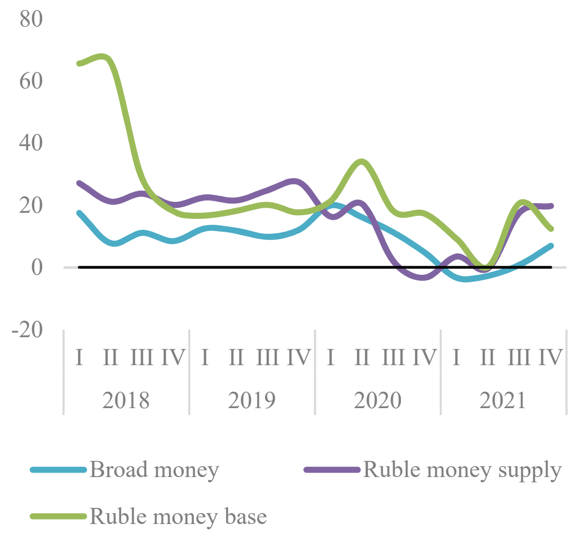
The monetary easing manifested itself in accelerated growth of monetary aggregates, which started in the second half of 2021. In 2021, the broad money supply went up by 7.0% (against 7.4% growth a year earlier), with most of the growth occurring in the second half of the year (9.9% in July–December). BYN money supply increased by 19.8% in 2021 against a decrease of 3.3% a year earlier. Its fastest growing component was transferable deposits—an increase by 29.3% against a decrease by 6.2% a year earlier.

Figure 3. *Inflation (in %, y-o-y, end of period)*



Source: Belstat

Figure 4. *Monetary indicators (in %)*



Source: Belstat, NBRB

Budget Sector and Public Debt

The economic growth, accompanied by a significant improvement in the financial position of business entities and higher tax payments, as well as some consolidation of budget expenditures contributed to the formation of a budget surplus. According to preliminary data, the general government budget was executed in 2021 with a surplus of 0.5% of GDP[6]—including

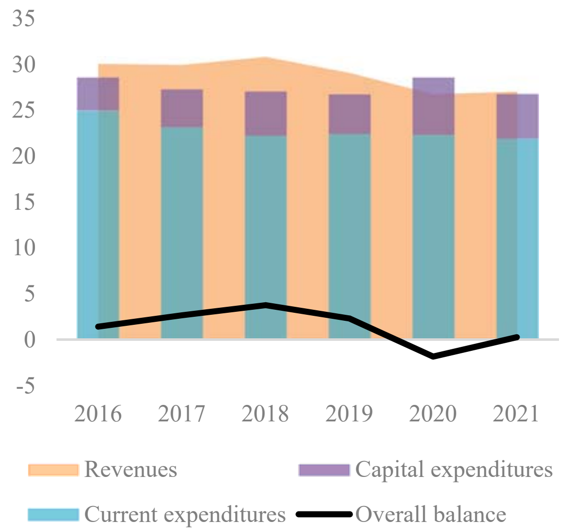
[5] According to the "Information on the Real Effective Exchange Rate of the Belarusian Ruble" published on the official website of the National Bank of the Republic of Belarus: https://www.nbrb.by/engl/publications/realcoursinfo

[6] The EFSD Project Unit has got only a preliminary report of the Ministry of Finance of the Republic of Belarus on the execution of the consolidated budget for 2021, which expenditure part does not take into account the so-called "closing turnover", i.e. the expenditures actually made in January 2022, but aimed at financing activities approved under the 2021 budget. The final report for 2021 will be ready at end-March 2022, and it may be expected to show a lower surplus or a shift to a deficit.

the budget surplus of the Social Protection Fund of 0.2% of GDP—against a deficit of 1.7% of GDP a year earlier. The primary balance was positive at 1.8% of GDP (-0.1% of GDP in 2020). Tax revenues rose to 24% of GDP against 22.4% of GDP a year earlier due to higher revenues from all types of taxes (except for property taxes). The most significant increase was registered for the profit tax (by 1.1 p.p.), which resulted in this tax reaching a peak for the last 8 years (up to 3.2% of GDP). In addition, higher revenues from the value added tax (due to an increase in the volume and value of products sold) and customs duties (*inter alia* due to higher imports to the EEC countries[7]) generated an additional increase in tax revenues by 0.5 p.p. of GDP. The consolidated budget expenditures, in their turn, amounted to 26.7% of GDP, which is 1.3 p.p. lower than in 2020, solely due to lower capital transfers. This was driven by two factors: a reduction of spending on replenishment of authorised funds of state-owned enterprises from 2.1% of GDP in 2020 to 1% of GDP in 2021, as well as a slight decline in investment projects financed by foreign development partners through project-related loans in the context of sanctions. Current expenditures remained at the level of the previous year (21.9% of GDP), although there was a slight change in their composition: while the expenditures on salaries and wages, and interest payments declined (by 0.2 p.p. of GDP for each of the items), the spending on subsidies and purchases of goods and services increased by an equivalent amount. The functional (sector) composition of expenditures also changed slightly: while the funding for almost all sectors was reduced, there was an increase in health expenditures as a result of the continuing COVID-19 pandemic (by 0.5 p.p.) and expenditures on the national economy (by 0.3 p.p.).

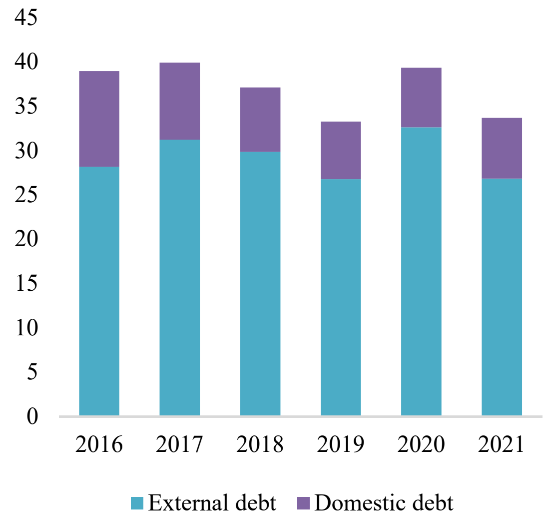
The budget execution with a surplus, including a primary surplus, contributed to a reduction of the public debt of the Republic of Belarus. It went down to 33.5% of GDP as at end-2021 from 36.7% a year earlier (Figure 6). The most significant decline was observed for the external debt – by 3.5 p.p. to 26.7%, while the domestic debt decreased by 0.5 p.p. to 6.8% of GDP. The decline of the direct Government debt, coupled with the rather restrained policy followed by the authorities as to providing guarantees, contributed to a reduction of the augmented public debt[8] to 41.2% from 47.5% of GDP a year earlier (Annex).

Figure 5. *State budget (in % of GDP)*



Source: RB MoF

Figure 6. *Public debt (in % of GDP)*



Source: RB MoF

[7] Since Belstat has ceased publishing data on exports of sanctioned goods, including oil, petroleum products and potassium, it is difficult to analyse their export trends.
[8] It includes the direct debt of the central and local governments of the Republic of Belarus, as well as external and domestic borrowings guaranteed thereby.

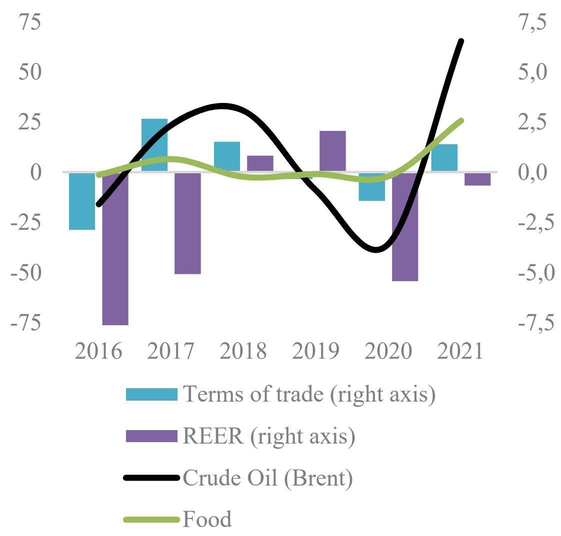
External Sector

High external demand and improved terms of trade contributed to a significant increase in the foreign trade surplus and the current account balance of Belarus. Physical volumes of exports (+9,9%) outpaced those of imports (+5.2%), and the terms of trade improved slightly due to higher export price growth (Figure 7), which resulted in a two-fold increase of the surplus of trade in goods and services to US$ 3.8 billion or 5.5% of GDP (US$ 1.9 billion and 3.1% of GDP a year earlier). Primary incomes showed a decrease in outflows abroad (3.9% of GDP against 4.3% a year earlier), mainly due to lower income accrued to foreign investors, which is likely to be due to a decline in net profits of companies in 2020 in the face of the pandemic. In this context, the current account had a surplus of US $1.8 billion (2.7% of GDP) against a deficit of US $0.3 billion (0.4% of GDP) a year earlier (Figure 8).

According to preliminary estimates, there was an outflow of 1.6% of GDP[9] under the financial account of the balance of payments in 2021. In the context of the persistent high uncertainty and low level of diversification of domestic investment instruments, households and enterprises built up their holdings of foreign assets under other investments (1.5% GDP), mainly in the form of cash and deposits (1.2% of GDP). In addition, against the background of the expansion of sanctions, the inflow of foreign direct investments decelerated (to 1.9% of GDP against 2.1% a year earlier), including reinvested incomes (to 1.0% of GDP against 1.7% a year earlier). Nevertheless, the formation of a current account surplus in excess of the net outflow under the financial account contributed to maintaining relative stability in the domestic foreign exchange market and the GIR level.

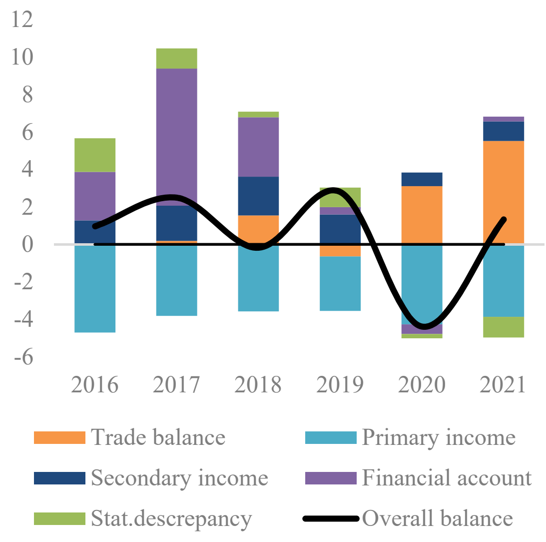
Moreover, as a result of an allocation of IMF Special Drawing Rights, the GIR went up from US $7.5 billion to US $8.4 billion as at end-2021. However, with the value of imports going up, the level of GIR decreased from 2.5 to 2.3 months of imports of goods and services.

Figure 7. *Terms of trade (in %, y-o-y)*



Source: World Bank, Belstat, NBRB

Figure 8. *Balance of payments (in % of GDP)*



Source: NBRB, Belstat

Financial Sector

Lending was suppressed in the first half of the year in the context of constrained money supply, while in the second half of the year, it accelerated in response to the monetary easing. The claims of banks and the Development Bank grew by 5.0% in 2021 against an increase of 24.4% a year earlier (or, respectively, 5.6 and 13.3% at the exchange rate fixed as at the

[9] Not including inflows of funds as a result of an allocation of IMF Special Drawing Rights in the amount of US $0.9 billion.

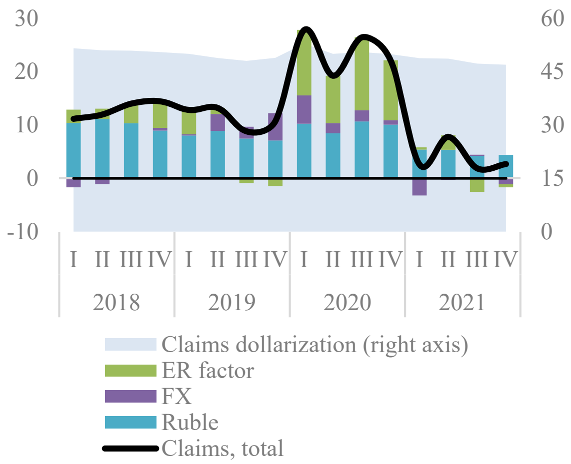
beginning of the year). At the same time, the growth in BYN claims decelerated to 9.6% against 20.5% a year earlier, and that of claims in foreign exchange[10] – to 1.3% against 5.1% a year earlier. Banks' claims on the economy increased mainly due to BYN lending (+7.4%), the growth of which accelerated significantly in the second half of the year amid the monetary easing (Figure 9).

The key driver of the growth of banks' BYN loan portfolio was lending to state-owned enterprises (+17.8%) and the housing sector[11] (+10.9%), accompanied by a significant deceleration in the segment of the private sector (+1.7%) and a decrease in consumer lending (-5.6%). The expansion of lending was facilitated by measures taken by the National Bank, including the provision of liquidity to commercial banks through substandard operations, as well as the Government's decisions to raise the directed lending ceiling from BYN 0.4 billion to BYN 1.4 billion. However, as the net financing of directed loans was negative, their share in the total claims of banks and the Development Bank on the economy went down to 13.2% as at end-2021 from 14.8% a year earlier.

The activity of household in terms of savings remained modest. The recovery in the growth of term BYN deposits of households (+12.5%) registered in 2021, following a drop in the previous year (-11.7%), was largely driven by the placement of the funds of the family capital[12] (an increase of about BYN 340 million). The total stock of term BYN deposits of households was still below the level of end-2019. Net of the family capital, the term BYN deposits of households increased by 4.9%, while deposits in foreign currency continued to decline. In 2021, they dropped by 11.3%, and compared to end-2019 – by 31.2%.

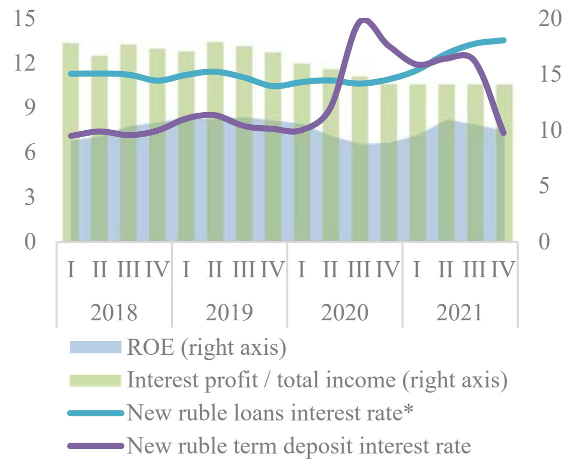
In general, banks' financial performance was relatively stable. The return on equity increased slightly in 2021 (from 8.9 to 10.0%) but was still below the level of early 2020 (Figure 10). The regulatory capital adequacy increased from 17.2% to 17.9%. The share of non-performing assets in assets exposed to credit risk increased slightly during the year (from 4.8% to 5.3%), although it was below the peak of 5.7% recorded in August 2021. The increase in non-performing assets amid stronger economic activity is likely to be a result of higher interest rates on bank loans, which limited the scope for refinancing previously received loans. The dollarisation of banks' claims on the economy decreased to 47.0%, its lowest value since 2013.

Figure 9. *Bank lending (in %, y-o-y)*



Source: NBRB

Figure 10. *Banking sector indicators*



Source: NBRB

[10] In the US $ equivalent.
[11] Including loans accompanied by subsidies to pay part of the interest and principal amount under Decree of the President No. 240 "On State Support of Citizens for Housing Construction (Renovation)".
[12] The family capital is a lump sum provided to families in a non-cash form at the birth (adoption) of a third child and subsequent children. The allocation of family capital is established by Decrees of the President of the Republic of Belarus No. 572 (in 2015–2019) and No. 345 (in 2020–2024). To control the use of the funds for the intended needs, the money is transferred only to the state-owned bank ASB Belarusbank OJSC.

ANNEX

Total Debt as a Basis for Fiscal and Debt Sustainability Analysis: the Case of the Republic of Belarus

The EFSD uses a broad definition of the public debt to perform debt and fiscal sustainability analysis, including that of quasi-fiscal risks posed by various debt instruments. This approach is justified by the context of the economic policies pursued by the Governments of most EFSD recipient countries, characterised by active engagement of the public sector of the economy in business processes, *inter alia* through facilitated access to financial resources on a repayable basis.

This approach was used to prepare a macroeconomic framework to agree on the threshold values of macroeconomic indicators for a potential budget support programme in the Republic of Belarus. The augmented public debt includes the direct debt of the central and local governments of the Republic of Belarus, as well as external and domestic borrowings guaranteed thereby. Under this approach, the total public debt of the Republic of Belarus as at end-2021 amounted to 41.2% of GDP (with the direct debt of the central government at the level of 33.5% of GDP).

The relevance of analysing the total debt is primarily based on the fact that it enables a more comprehensive assessment of the scale of contingent liabilities of the Government of the Republic of Belarus and their contribution to boosting the direct debt of the Government and the financing needs of the budget if they materialise. The paper, prepared by the EFSD Project Unit in 2021 to assess the potential risks of contingent liabilities of the EFSD recipient countries materialising and their impact on the countries' fiscal and debt positions[13], finds that Belarus is in an area of relatively high fiscal risks. It is primarily a consequence of active state interventions in economic activities and support of state-owned enterprises through various debt instruments.

In particular, the paper highlights that the guarantees provided to economic entities with a share of the state (5.2% of GDP as at end-2021) pose a high fiscal risk, especially in terms of external guarantees. An analysis of the relevant regulatory framework has shown that, in Belarus, government guarantees are provided mainly to state corporations in those sectors of the economy, in which state interventions are not economically justified, as it creates an uneven playing field[14]. In 2020, 7% of the total stock of guarantees was concentrated in the transport sector, 11% – in the energy sector, and 55% – in industry. Despite the fact that a significant part of government guarantees was provided to stimulate the investment activity of enterprises with a predominant share of state ownership, the results of the study show that state-owned companies are less efficient in allocating labour and capital. In 2016–2020, while the average investment per employee was 44% higher in state-owned companies than in the private sector, their value added was 35% lower. This indicates lower profitability of state-owned enterprises and higher insolvency risks, including default on guaranteed debts, especially in the context of deteriorating internal and/or external conditions. As at end-2021, 72% of total overdue loans and credits in the economy were accumulated by entities with a share of state ownership. The total stock of bad debts of state-owned enterprises was estimated by the authorities of Belarus at 14% of GDP.

An objective assessment of the risks to debt and fiscal sustainability generated by guaranteed debt is further complicated by the practice introduced in recent years of empowering state-owned banks to provide guarantees for external borrowings, which is not classified as public debt. According to the EFSD Project Unit, in 2020, state-owned banks provided guarantees in the amount of US $200 million, and in the first six months of 2021, they reached almost US $300 million. The position of the EFSD Project Unit is that the decision to transfer the powers to provide external guarantees to state-owned banks poses substantial risks of increasing debt burden of the Government against the background of systemic problems in the state-owned sector of the economy, especially in the event of economic shocks. In addition, the quality of assets of state-

[13] E. Vinokurov, N. Lavrova, D. Taltaev EFSD Working Paper WP/21/2 "Total Debt is So Much More Than Just Sovereign Debt. Contingent Liabilities in Armenia, Belarus, Kyrgyz Republic, and Tajikistan".

[14] In most transition economies, government guarantees are provided mainly to natural monopolies, for example, in the energy or transport sectors.

owned banks themselves is undermined by the still high share of directed loans in their portfolio (about 14%), which may aggravate the need for additional support for these banks through their recapitalisation from the budget.

Accounting for and analysis of the debt of local government and self-government bodies is another important aspect of a more objective analysis of the fiscal and debt sustainability of the Republic of Belarus. As at end-2021, the debt of local budgets amounted to 2.5% of GDP, of which 0.9% of GDP were guarantees issued. Despite the fact that the Budget Code (Article 65) establishes that local governments “bear unconditional obligations” to service and repay their debts and these debts are, therefore, not classified as public debt, the level and quality of these debts are an important element of the country's fiscal and debt sustainability analysis. Of particular concern is the fact that in recent years, in order to support state-owned enterprises in easing their loan debt burden, local governments have been issuing debt obligations denominated in a foreign currency, the share of which is 37% of the total debt[15]. In the absence of foreign exchange revenues of local budgets, this generates an additional liquidity risk, addressing which may also fall on the shoulders of the central government.

The sharp deterioration in the macroeconomic conditions in late 2021 – early 2022 may result in a significant increase of the public debt level in the Republic of Belarus in the medium term. Despite the greatly diminished opportunities to mobilise new loans against the background of the sanctions imposed by Western countries, the debt burden growth will be primarily driven by the projected GDP contraction and BYN depreciation. Under these conditions, the need for financial resources for debt servicing increases significantly, which will call for a radical tightening of fiscal policy, enhanced monitoring, and preventive measures to mitigate default risks for both direct and contingent liabilities of central and local governments.

It should be noted that, back in 2017, in the framework of its review of the fiscal rules of the Republic of Belarus[16], the IMF recommended the country's authorities to establish, legislate, and communicate to the public a medium-term fiscal anchor, targeting a safe debt level, including all levels of government and guarantees, in order to improve the quality of debt and fiscal management. According to IMF experts, the safe public debt level was 45–50% of GDP at that time, but it was stressed that a thorough and comprehensive assessment of fiscal risks was necessary to better calibrate the targeted level. Given the shocks of the COVID period and the impact of sanctions on Belarus' economy, the recommendation to establish a safe debt level based on an assessment of fiscal and quasi-fiscal risks gains in importance.

[15] In the first half of 2021.
[16] IMF, Selected Issues, 29 November 2017 (cr17384r).