

Belarus Economic Insights: Economic growth is feasible, but limited

The Belarusian economy keeps recovering, recording GDP increase and inflation reduction, but a significant factor restraining active economic growth is the uncertainty in the timeframe for the end of the war in Ukraine and in terms of any future easing of the EU/US sanctions.



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Key financial figures

	2022	2023	2024
Real GDP (% yoy)	-4.7	1.5	2.0
Nominal GDP (USD bn)	73.0	74.1	74.2
CPI Inflation (eop, % yoy)	12.8	8.5	9.0
Unemployment (avg, %)	3.6	4.0	4.0
Budget Balance (% of GDP)	-0.8	-1.2	-
Public Debt (% of GDP)	37.1	34.5	31.8
Current Account Balance (% of GDP)	3.8	-1.9	-0.1
FX Reserves with Gold (USD bn)	7.9	7.0	6.5
EUR/LCY (eop)	2.93	3.42	3.91
USD/LCY (eop)	2.7	3.1	3.4

Source: Refinitiv, local sources, RBI/Raiffeisen Research

Summary

- **Industrial output and capital investments became the main drivers of GDP growth**
- Rising consumer/investment imports and declining exports of services led to a **significant reduction in the foreign trade surplus**
- **Inflation dropped** to a historic low
- Summer **RUB devaluation caused BYN to depreciate** against USD by more than 18% YTD

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GDP growth is possible, but extremely restricted

The **lingering war** in Ukraine and the uncertainty of when its active phase will be over remains **the most significant challenge** and uncertainty for the economic outlook in Belarus. The impact of the EU/US sanctions on Belarus was largely mitigated by agreements with Russia on the use of its transportation infrastructure, as well as the increased reliance on the Russian ruble and the Chinese yuan for foreign trade settlements.

In the seven months of 2023, **GDP was supported by an industrial output** gain (due to increased demand in the Russian market and recovery of fertilizers and petrochemicals exports), **by higher capital investment** owing to government support and expansion of bank lending, and by **domestic demand under the influence of rising household income**. The consistent inflation decline resulting from government price regulation also helped to stimulate economic activity in Belarus.

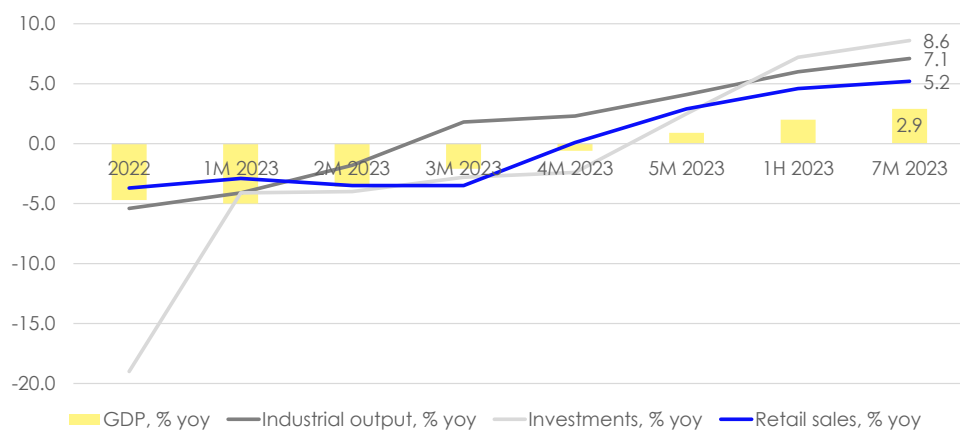
On the other hand, some **favourable 2022 base effects in all components will diminish** by the end of 2023. In addition, the **imbalance of export/import flows** and **BYN depreciation against USD**, which emerged in 1H 2023, will put some stress on the economic performance in 2023. In the absence of a countervailing increase in FX earnings from exports and the inability to attract financial resources in the Russian or other markets, the negative impact on the Belarusian FX market may intensify BYN devaluation and, subsequently, inflationary processes. At the same time, the sources of internal investment for technological modernization remain insufficient, while excessive use of the emission mechanism may accelerate inflation. External funding for Belarusian industry from joint projects with Russia, as well as Chinese investments (Great Stone Industrial Park), are delayed due to lengthy procedures of project review/approval. Moreover, **IT services and transportation are still on the declining path**.

In 7M 2023, GDP expanded by 2.9% yoy. The key drivers of its growth were industrial output (+7.1% yoy), capital investment (+8.6% yoy), retail sales (+5.2% yoy), and agriculture (+5.2% yoy). Industrial production was also supported by the low 2022 comparison base. The increased domestic investment in modernization, acceptable costs of Belarusian commodity exports transit via Russian transport infrastructure, and improved access to the Russian market, including participation in state-funded programs, may help maintain industrial output growth at 4.5% yoy.

In 2H 2023, **capital investment and retail sales expansion**, driven by loan availability and reinvestment by non-resident companies, **are expected to be the main supporters of the economy**. **Risk factors** include **higher inflation and pressure on consumer demand** from rising import costs.

Given the current dynamics, **we updated our GDP forecast** to 1.5% yoy growth by the end of 2023. In addition, these assumptions can create opportunities for further economic increase to 2% yoy in 2024.

Chart 1 - Capital investment and domestic demand will be the key GDP drivers



Source: Belstat, RBI/Raiffeisen Research

Surging imports gradually unbalance foreign trade and current account

In 1H 2023 compared to 1H 2022, **import expansion significantly exceeded the growth of exports**: exports of goods increased by 12.2% yoy, imports of goods jumped by 21.3% yoy, while exports of services dropped by 5.1% yoy and imports of services rose by 26.8% yoy. These changes were driven by the increase in consumer and investment merchandise imports combined with a slide in transportation and IT services exports dynamics.

Another H1 2023 trend became **the change in the geography of commodity flows**: in 5M 2023 a USD 1.95 bn surplus was formed with CIS countries vs. USD 0.81 bn deficit in 5M 2022, while with non-CIS countries a deficit of USD 3.31 bn in 5M 2023 replaced a previous surplus of USD 0.56 bn in 5M 2022.

In general, these **tendencies facilitated a considerable fall in the total foreign trade surplus** in 1H 2023 (USD 0.17 bn) compared to 1H 2022 (USD 2.48 bn). In foreign trade of goods, the surplus in 1H 2022 reversed to a deficit in 1H 2023, while the surplus of foreign trade in services decreased.

In addition to **the narrowing of the foreign trade surplus, a deficit of labor and investment income led to the USD 1.8 bn current account negative balance** in 4M 2023 vs. USD 1.1 bn deficit in 4M 2022.

In 2H 2023, export conditions are not expected to improve significantly because of the logistical limitations of commodity exports and growing competition in the Russian market from Chinese consumer/investment imports. On the other hand, BYN devaluation against USD and CNY may reduce consumer/investment imports in the Belarusian domestic market.

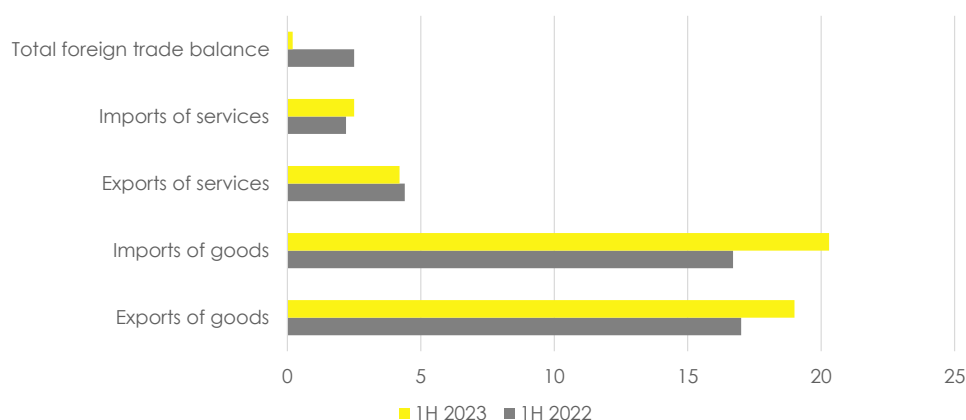
Considering the current developments the **growth of the commodity deficit may reach USD 1.5 bn, while the negative C/A balance could increase to USD 1.4 bn in 2023**.

In 2024, the pace of export gains for Belarusian fertilizers, foodstuffs, forest products, and petrochemicals will depend on maintaining the rail transit costs through Russia and the ability of the Russian transport infrastructure to handle Belarusian cargoes. The lifting of sanctions restrictions on Belarusian logistics in Poland and the Baltic states is unlikely. Exports to the Russian market may increase if production growth in joint industrial projects of the two countries and a greater involvement of Belarusian IT-companies in the Russian market take place. In turn, the government may use additional administrative regulation measures in case of excessive import pressure on the domestic market. In

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2024, all these factors may contribute to the reduction of the merchandise and C/A deficits to USD 1.0 bn and USD 0.1 bn, respectively.

Chart 2 - Foreign trade still balanced, but with risks



USD bn

Source: National Bank of Belarus, RBI/Raiffeisen Research

Following RUB the BYN significantly depreciated against USD

The **change in the direction of foreign trade flows** caused by the EU/US sanctions in 2022 **resulted in sharp growth of RUB's share** in the interstate foreign trade settlements and, consequently, **raised the degree of USD/RUB fluctuations on the USD/BYN dynamics**.

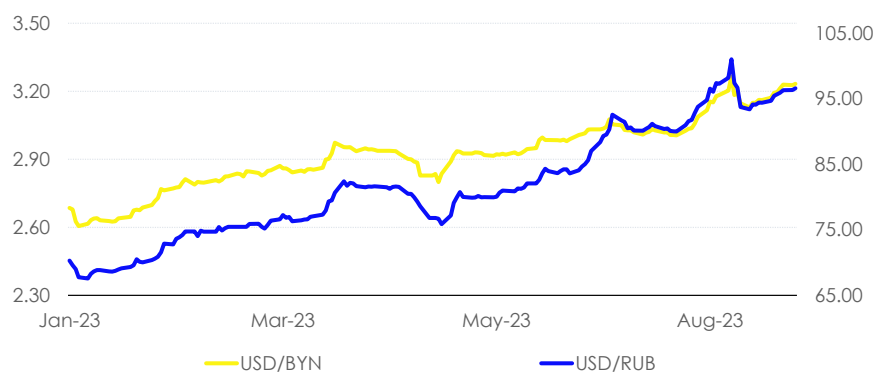
At the same time, during the periods of rapid short-term RUB depreciation against USD, the **National Bank of Belarus (the NBB) took measures to smooth BYN/USD depreciation**, as evidenced by BYN strengthening against USD despite the falling RUB.

Since the beginning of this year, the Belarusian ruble has devalued against the US dollar by 18.15% to 3.23 USD/BYN, while vs. the Russian ruble, it has appreciated by 11.3% to 3.36 100RUB/BYN. Against the Chinese yuan, the Belarusian ruble weakened by 15.36% to 4.46 CNY/BYN (as of Sept. 5, 2023). Moderate BYN devaluation against USD contributed to financial stability — FCY supply in the domestic FX market exceeded demand by USD 0.51 bn as of Aug 1, 2023.

In Q4 2023, **USD/BYN will continue to closely track USD/RUB**, which implies a strengthening of the Belarusian ruble against the US dollar. In this case, **BYN is expected to depreciate against RUB**, which will **contribute to the competitiveness of Belarusian exports in the Russian market**.

Based on these dynamics, we **worsen our expectations for the USD/BYN to 3.05** by the end 2023. In 2024, according to the baseline scenario, the Belarusian ruble may moderately depreciate against the US dollar and the Chinese yuan by 10-15%, while RUB/BYN may change in a narrower range (-5%/+5%) in 2024.

Chart 3 - NBB takes measures to offset sharp BYN depreciation



Source: National Bank of Belarus, RBI/Raiffeisen Research

CPI hikes ahead, NBB's cautious rates policy

Since the beginning of 2023, **CPI decreased from 12.0% yoy to 2.7% yoy in July 2023**. The **downward prices dynamics was facilitated by:**

- Imposed strict state price regulation
- 2022 statistical comparison base
- Moderate growth of consumer import costs
- BYN appreciation against RUB in 1H 2023 (restrained import prices of intermediate and energy goods from Russia created opportunities for moderate prices increases for public utilities and energy tariffs for households).

In 2H 2023, the impact of the above factors on inflation will be reduced. At the same time, the negative impact on prices associated with BYN depreciation against USD, CNY and RUB may increase. **Given these circumstances, inflation is expected to rise to 8.5% yoy in 2023 with price pressure likely to extend also to 2024.**

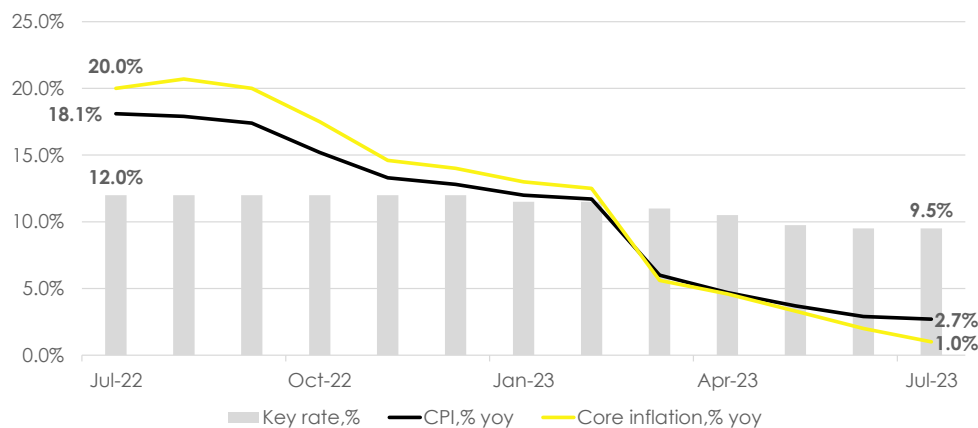
Following the declining inflation, the **National Bank of Belarus cut the key rate from 12.0% to 9.5% per annum in 1H 2023**. Also, in order to boost bank lending, the estimated values of standard risks for Belarusian banks (EVSR) on new loans for legal entities were reduced from 13.77% to 10.82% p.a. and for households — from 18.24% to 14.61% p.a. in January-September 2023. At the same time, the **NBB did not use non-interest instruments to regulate the money supply in 1H of this year.**

Despite CPI falling, in the beginning of 2H 2023 the **National Bank suspended the cycle of interest rate cuts**. Given the expected inflation hike by the end-2023, the **regulator may lower the key rate only slightly going forward (to 9%) or stop cutting rates altogether.**

In 2024, we expect an **increase of the key rate to 10.0% p.a.** as well as EVSR which should be **determined by accelerating inflation.**

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Chart 4 - Despite declining inflation NBB stopped key rate cutting



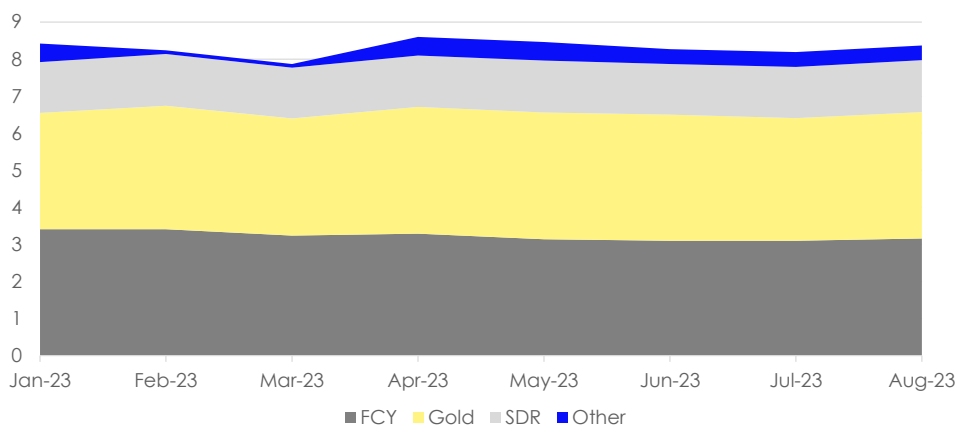
Source: National Bank of Belarus, RBI/Raiffeisen Research

The National Bank saves FX reserves

The NBB started to release FX reserves data with a detailed description by components again. As of August 1, 2023, **FX reserves amounted to USD 7.97 bn** and increased by USD 182 mn compared to July 2023. Their growth was caused by an increase in global gold prices. The level of FX reserves allows for paying foreign debts and conducting FX interventions to maintain stability in the domestic FX market. We expect the National Bank to continue to pursue a policy of cautious spending and improve **our forecast for FX reserves to USD 7.0 bn in 2023.**

It should also be noted that in the absence of external funding from the EU and limited financing from Russia, **the gross external debt decreased to USD 37.6 bn** as of April 1, 2023 (in 2022 it amounted to USD 39.8 bn). In view of the potential limited funding from Russia, **we assume that gross foreign debt could reach USD 38.5 bn in 2023.**

Chart 5 - The National bank utilizes FX reserves quite restrictively, USD bn



Source: National Bank of Belarus, RBI/Raiffeisen Research

All in all, despite the quite optimistic economic performance at present, and taking into account the sizable downward pressure on the Belarusian economy, **we keep a rather conservative approach in our projections, expecting a moderately low GDP growth coupled with a high risk of rising consumer prices by the end of 2023.**

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