

Belarus Business Forecast Report Q2 2014

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Abstracts

Core Views

Belarus's economic outlook has improved somewhat from the dire projections following the potash dispute in mid-2013, as potash trade and political relations with Russia recover. However, we do not expect to see a significant rise in net exports, due to the relative strength of the ruble against regional peers and the likelihood of Ukrainian trade being disrupted by the flare up between Kiev and Moscow.

We see risks to Belarus's inflation outlook in 2014 and 2015, as the government places pressure on the central bank to implement measures to stimulate growth, rather than targeting inflation. This will likely come in the form of continued ruble weakening as well as an expansion of the money supply and further reductions to reserve requirements at the central bank.

Belarus's current account deficit will remain substantial over the coming years, driven by declining export volumes and a reduction in remittances from Russia. The outlook is made bleaker by the fact that the deficit continues to be financed by depleting FX reserves and the extension of credit lines from the Russian government that are subject to the political whims of Moscow.

Belarus will remain fairly insulated politically from the ongoing crisis in Ukraine, with its allegiances firmly skewed towards Moscow and little chance of a 'EuroMaidan'-style uprising occurring within its borders. In the longer term we cannot rule out similar upheaval, especially around the November 2015 presidential election, but our core scenario remains one of stability under the firm control of President Alexander Lukashenko.

Major Forecast Changes

We expect to see the Russian rouble and the Ukrainian hryvnia continue to weaken in 2014 and 2015, and the Kazakh tenge should remain around current levels given the country's substantial FX reserves. As a result of the weakness required to regain export competitiveness we have revised our forecasts for the Belarusian ruble, from averaging BYR9,970/US\$ and BYR10,550/US\$ in 2014 and 2015 previously, to BYR10,500/US\$ in 2014 and BYR11,800/ US\$ in 2015.

Key Risks To Outlook

Given that the situation on the ground in Ukraine is fluid at the time of writing, there remain risks to our view for Belarus to remain politically stable. It is not in our core scenario for a ground war to break out in Crimea or Ukraine's eastern oblasts, but if this were to occur, it would undoubtedly raise Belarus's security risks as a wider conflict in Ukraine could draw in neighbouring states.

The key risk to our macro outlook is a sharp devaluation of the ruble by the central bank, rather than a managed depreciation. If key trading currencies sell off more than expected, or the Russian government is unable or unwilling to provide additional financing beyond the US\$2bn loan agreed in 2013, a devaluation would become a much more realistic possibility. Of course the worst case scenario for the ruble would be an escalation of violence in Ukraine and the outbreak of a ground war in the country. This would have significant negative spill over effects for the currency, as Belarus's macro outlook deteriorates further on a decline in regional trade as well as fixed investment.

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Belarus's long-term political stability is jeopardised as a result of the country's lack of institutional development beyond the executive branch. Consequently, while our core scenario is for President Alexander Lukashenko's regime to maintain its grip on power over the long term, we do not rule out the possibility of growing public dissatisfaction resulting in a sudden change of leadership or direction, particularly in light of the country's recent economic crisis. We believe the country's greatest challenge over the coming decade will stem from the regime's efforts to diversify its foreign policy agenda while maintaining strong links with Russia.

CHAPTER 2: ECONOMIC OUTLOOK

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Belarus's economic outlook has improved somewhat from the dire projections following the potash dispute in mid-2013, as potash trade and political relations with Russia recover. However, we do not expect to see a significant rise in net exports, due to the

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Belarus's current account deficit will remain substantial over the coming years, driven by declining export volumes and a reduction in remittances from Russia. The outlook is made bleaker by the fact that the deficit continues to be financed by depleting FX reserves and the extension of credit lines from the Russian government that are subject to the political whims of Moscow.

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We see risks to Belarus's inflation outlook in 2014 and 2015, as the government places pressure on the central bank to implement measures to stimulate growth, rather than targeting inflation. This will likely come in the form of continued ruble weakening as well as an expansion of the money supply and further reductions to reserve requirements at the central bank.

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