

Belarus Business Forecast Report Q4 2013

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Abstracts

Core Views

The breakup of the Belarusian Potash Corporation (BPC) and the subsequent arrest of Uralkali chief executive Vladislav Baumgertner has led to a severe deterioration in the relationship between Belarus and Russia, and poses significant threats to the Belarusian economy. Punitive embargo's placed on Belarusian exports by Moscow, and a decline in potash production will exacerbate the country's current account deficit and impact negatively on real GDP growth in 2013 and into 2014.

The Belarusian ruble is set to depreciate further in the months ahead as the currency comes under increasing pressure from a current account deficit which is set to rise through the remainder of 2013 and into 2014, and FX reserve levels which, although increasing, still remain woefully inadequate to cover the country's imports.

Consumer price inflation has continued to fall throughout the course of 2013, coming in at our year-end target of 15.0% year-on-year (y-o-y) in August. Declining food price inflation, which carries the heaviest weighting (47.2%) in the consumer price basket, has been the primary driver behind the fall in the headline rate. Inflation is set to tick up in 2014 as the weakness of the ruble exacerbates imported inflation.

Major Forecast Changes

We have revised down our forecast for real GDP growth in 2013 and 2014, from 0.3% and -1.1% to -0.4% and -2.8% respectively, as the impact of the decline in potash production leads to falls in net exports and fixed capital formation. In addition, household consumption growth is set to weaken as rising inflation reduces households' purchasing power.

Our forecast for consumer average consumer price inflation in 2014 has been raised from 12.5% to 17.5% on the back of the likely weakness of the Belarusian ruble. We have also raised our forecast for the Belarusian refinancing rate in 2013 and 2014, from 15% and 10% to 23.5% and 25%. We do not believe the central bank will risk further rate cuts in 2013 for want of a weaker ruble, and will be forced to raise rates in 2014 to stem inflationary pressures.

The Belarusian current account is set to widen significantly over the coming quarters as potash, petroleum and pork exports decline as the effect of the brewing trade war with Russia becomes apparent. Therefore we have significantly altered our forecast for Belarus's current account deficits to 9.4% of GDP and 9.5% in 2013 and 2014 respectively, from 2.3% and 1.2% previously.

Key Risks To Outlook

Should the governments of Belarus and Russia come to an amicable settlement over the potash dispute, we could see not only a full resumption in trade between the two states, but also a restart to the Belarusian Potash Corporation. This would markedly reduce the risk to the country's current account, currency and real GDP growth prospects. However, given the vitriolic rhetoric between the two states we believe it will take a long time for relations to return to their previous cordial state.

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Following from the break-up of the Belarusian Potash Corporation, and the subsequent arrest of Uralkali chief executive Vladislav Baumgertner, the political and economic relationship between Russia and Belarus is set to remain extremely strained over the coming months. Russia has already reduced crucial oil supplies and we do not rule out further punitive action.

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Focus On Russia Despite Potash Dispute

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.

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The Belarusian economy is set to suffer a prolonged period of economic instability and decline as a result of a decline in global potash prices and an escalating trade war with Russia. If Russo-Belarusian relations cannot be patched up, state revenues are set to decline considerably, the net exports deficit will widen significantly and real GDP growth will decline significantly.

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Retaliatory Measures Reinforce Livestock Strategy

The potash dispute between Russia and Belarus is escalating after Uralkali's CEO was arrested in Minsk in August. We believe retaliatory measures taken since then on the Belarusian energy and livestock industry will reinforce Russia's position over its neighbour. The sanitary angle will continue to be used to limit pork exports from Belarus in the near term, at least until a solution to the potash situation is found. Also, this is in line with the country's recent strategy to boost meat and dairy self-sufficiency.

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