

Belarusian Monthly Economic Review

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- When Belarus will get its credit rating is still uncertain.
- The program on energy security was drafted.
- The government is considering taking measures to reduce imports.
- Deposit interest rates have increased.
- The banks' statutory funds were increased at the expense of centralized sources.

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Politics: When Belarus will get its credit rating is still uncertain

At a joint session of the NBB and the government President Lukashenko stated that in spite of the sustainable growth of the Belarusian economy the rating agencies would likely assign a low sovereign credit rating (speculative or even default) to Belarus, due to political factors. He therefore urged the government not to pursue this matter vigorously. Previously the authorities had hoped to obtain the sovereign credit rating during the first quarter of 2005.

Real sector: The real GDP grew by 11% in 2004

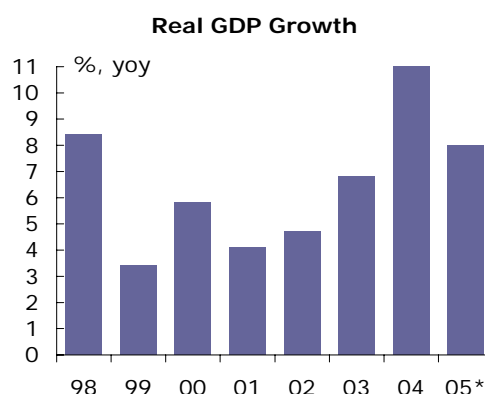
According to official statistics, the real GDP grew by 11% in 2004. This is four percentage points higher than in 2003. The main factors causing this growth from the demand side were household consumption and fixed capital investment. According to our estimates, these two components contributed 9.9 percentage points of the GDP growth, i.e. 90% of its increase. Increases in household consumption resulted from higher incomes, caused by wage and pension increases of 17–17.5% in 2004. Improvements in the financial statuses of enterprises and more credit granting stimulated investment growth in the economy.

On the supply side, industry contributed most to the GDP growth. Industrial production grew by 15.6% in 2004. Machine building, metalworking and the fuel sector ensured half of the increase. Higher demand coming from Russia stimulated the machine building sector output. The fuel industry growth was due to increased Russian oil deliveries destined for refining by Belarusian enterprises.

Structural trends: The government drafted the program on energy security

Energy sector. The Russian gas price increase for 2005 caused President Lukashenko to raise the question of energy security. He stated that Belarus' dependency on Russian gas is a threat to the country's security and sovereignty. The government thereupon drafted a program, entitled "Energy Security of the Republic of Belarus for 2005-2010 and until 2020." The document states that the share of local fuel sources within the energy balance of the country should rise from 13–15% to 25–30%. The authors of the program estimate that this would require an investment of USD 5 bn. Sources for such a huge investment are still unknown. At the same time, the payback period might be of the order of several dozen years. Yet, should the price of Russian gas remain at the 2005 level (USD 46.67 per 1000 m³), Belarus could import 107 bn m³ of gas for the same USD 5 bn, which approximately equals the gas consumption of the country over a period of five years.

Population: 9.8 m
Industry/GDP: 25.5%
Agriculture/GDP: 6.1%
Investment/GDP: 18.6%
Export destination: Russia 49%, EU 23%
Import origin: Russia 66%, EU 15%



* Own estimates.

Source: Ministry of Statistics and Analysis.

Institute for Privatization
and Management (IPM)
76 Zakharova St., Minsk 220088, Belarus
Tel./fax (+375 17) 236-11-47
E-mail bmer@ipm.by
Internet http://ipm.by/

Foreign trade: The government is considering taking measures to reduce imports

Exports increased by 38.1% yoy and imports by 37% yoy during the first 11 months of 2004. The mineral products trade caused about half of the exports increase and one third of the imports increase. As a result, non-CIS countries that are buyers of oil products had higher exports increases than did Russia. Russia's share in Belarusian exports dropped by 2.4 percentage points compared to Jan-Nov 2003, amounting to 46.6%. Russia's share in imports increased by 1.9 percentage point and reached 67.9%.

Due to the significant increase in oil products exports, the merchandise trade balance with countries outside the CIS increased by USD 395.8 m in Oct-Nov compared to the same period of the previous year. This cushioned the merchandise trade deficit with Russia somewhat, which for Jan-Nov amounted to USD 3.8 bn. It increased by USD 0.5 bn for Oct-Nov when compared to the same period of the previous year.

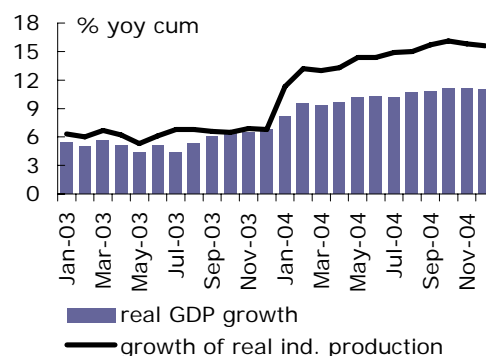
The government is concerned with the growing trade deficit. It suggested taking measures to reduce imports, especially of consumer goods (primarily non-food products). Firstly, the government is considering introducing third country customs clearances for goods imported from Russia. This measure is directed at liquidating "gray imports." Secondly, the introduction of customs registrations of third country goods imported into Belarus by physical entities is also being considered. Taking such measures could lead to higher prices for imported goods, which will have a negative impact on Belarusian consumers. In addition, import restrictions are not likely to increase the competitiveness of Belarusian enterprises. Over the mid-term, they could even deteriorate their competitiveness.

Public finance: The new VAT payments regime has caused problems

According to preliminary information, the consolidated revenues (excluding the Social Security Fund) amounted to 36.0% of GDP in 2004, which is 2.7 percentage points higher than in 2003. The arrears due to the state by economic entities decreased by 5.9% in 2004. The consolidated revenues grew mainly due to higher VAT and profit tax revenues. In 2005, the share of the consolidated revenues in GDP will increase further, despite the decrease in some tax rates. This is due to the fact that innovation funds will be introduced into the budget, some tax benefits and preferences benefiting enterprises will be eliminated, and income tax revenues will increase due to an expected wage rise. Additionally, due to the negative trade balance between Belarus and Russia, the change of the regime of indirect tax payments from the country of origin to the country of destination for the trade with Russia will lead to a higher tax burden.

The agreement between Belarus and Russia on VAT payments based on the principle of the country of destination took force on January 1, 2005. It caused several problems connected primarily with the mechanisms of paying the tax and lack of information on this issue within the economic entities and the tax bodies. If Russian importers do not pay VAT, the Belarusian exporters should pay it and vice versa. This will require exporting enterprises to withdraw some turnover capital from production process in order to make tax payments. To avoid this risk, exporters could suspend deliveries and/or increase prices by the VAT amount. However, Belarusian enterprises can hardly increase prices, as competition on the Russian market is quite tough. Russian enterprises are in many cases the only suppliers of raw materials to Belarus, which enables

GDP and Industrial Production



Source: Ministry of Statistics and Analysis.

Contribution to GDP Growth

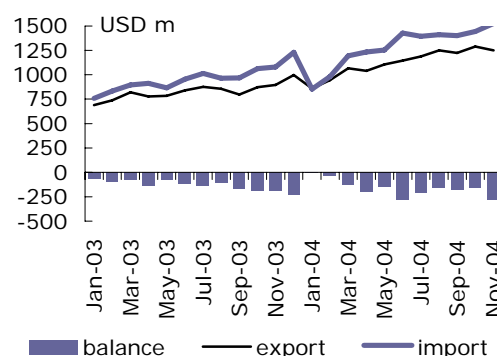
| Contribution of the components, percentage points | 2003* | 2004** |
|---|------------|-------------|
| Final consumption expenditure | 4.5 | 7.5 |
| Households | 4.4 | 6.4 |
| General government | 0.1 | 1.0 |
| Non-profit institutions serving households | 0.0 | 0.1 |
| Gross capital formation | 4.3 | 4.6 |
| Gross fixed capital formation | 4.0 | 4.3 |
| Change in inventories | 0.3 | 0.3 |
| Net export of goods and services | -3.0 | -1.2 |
| Statistical discrepancy | 0.7 | 0.1 |
| GDP growth, % | 7.0 | 11.0 |

* Estimates of the IPM Research Centre based on the revised data on GDP growth in 2003.

** Estimates of the IPM Research Centre.

Source: calculations based on the Ministry of Statistics and Analysis Data.

Merchandise Trade Dynamics



Source: Ministry of Statistics and Analysis.

Contribution to the Imports and Exports Growth

| | Jan-Nov 04 compared to Jan-Nov 03 | |
|--------------------------------|-----------------------------------|-------------|
| | Export | Import |
| Mineral products | 15.3 | 13.3 |
| Machinery and equipment | 3.0 | 6.3 |
| Transport | 4.3 | 1.9 |
| Chemical products | 4.5 | 4.4 |
| Textiles | 0.9 | 0.5 |
| Agricultural and food products | 3.4 | 3.0 |
| Base metals | 3.7 | 6.3 |
| Others | 3.2 | 1.2 |
| Total, % yoy | 38.1 | 37.0 |

Source: Own calculations based on the Ministry of Statistics and Analysis data.

them to raise prices. The new regime of VAT payment also threatens the existence of so-called “gray schemes” and of cash payments between economic entities of the two countries. A special government commission has been set up to deal with these problems.

Monetary policy: Increase of deposit interest rates

The money base rose by 17.6% mom in December. This large increase was caused by an increase of net foreign assets and “other net domestic assets”. The main reason for the net foreign assets increase (27.8% mom in December) was the inclusion of a Russian government loan in the amount of USD 175 m in the official hard currency reserves. Bank refinancing as a tool to increase the money supply was practically not used in December.

The banking system faced a liquidity deficit problem during December, since the money supply increased only at the very end of the month. As the price of resources in national currency at the inter-bank market was much higher than the deposit interest rates, the banks continued to increase household and enterprise deposit interest rates. This, in addition to the increase of real income of the population led to an increase of time ruble deposits for households by 9.3% mom. Also, the banks raised the hard currency deposit interest rates considerably (by 2.4 percentage points in December). This led to an increase of hard currency deposits by individuals by 9.9% mom. As a result, the banks managed to increase their net foreign assets.

Together with their intensified activities to attract deposits, the banks limited giving hard currency loans (this applies primarily to Belagroprombank and Belarusbank). As a result, crediting of the economy slowed down. As hard currency resources got more expensive, hard currency loans followed suit. The average interest rates on most of ruble credits decreased a little due to lowering interest rates by the big banks. This was a part of the NBB’s plan for lowering credit interest rates.

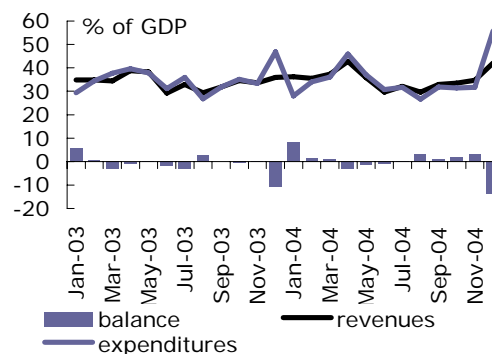
Cash in circulation increased by 11.8% mom in December. Together with the increase of all types of deposits caused by the banks’ interest rate policies, this led to a growth of the money base by 9.2% mom. Consumer prices grew by 2.1% mom (14.4% yoy) in December. The Belarusian ruble depreciated by 0.15% relative to the US dollar. Its exchange rate was 2,173 BYR/USD on January 31.

Banking sector: The banks’ statutory funds were increased at the expense of centralized sources

Based on three presidential decrees signed in December 2004, the statutory funds of three authorized banks were increased at the expense of centralized sources. Specifically, local authorities were encouraged to deposit housing and innovation fund resources in the statutory funds of Belarusbank and Belagroprombank. The government’s share in Belarusbank rose by BYR 172 bn and in Belpromstroibank by BYR 15.2 bn through the issuance of 10-year government bonds. This scheme of increasing the statutory capital of the biggest banks, in reality resulted in an increase of the share of government bonds in the banks’ portfolios without additional resources for crediting being created.

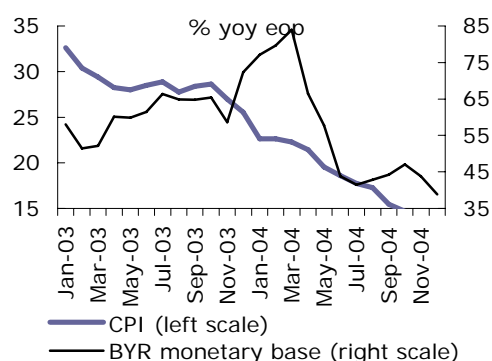
The NBB allowed the 13 biggest enterprises to open additional Belarusian ruble current bank accounts. This measure will ease access by these enterprises to credit resources. At the same time, it will not intensify competition in the banking sector, since additional accounts can be opened only at three authorized banks, namely Belarusbank, Belinvestbank and Belpromstroibank.

Consolidated Budget*



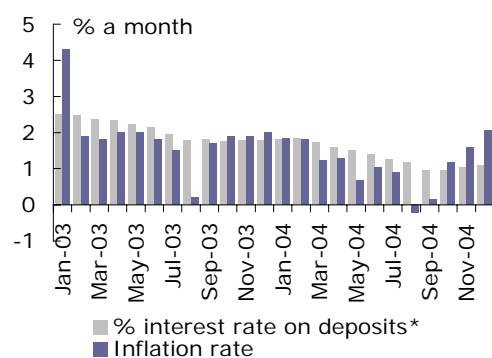
* Without Social Security Fund.
Source: Own calculations based on the Ministry of Statistics and Analysis and the NBB data.

Ruble Monetary Base and CPI



Source: Own calculations based on the Ministry of Statistics and Analysis and the NBB data.

Inflation and Interest Rates



* Interest rates on new household deposits in BYR.
Sources: NBB, own calculations.

| Economic Trends | | Q1 03 | Q2 03 | Q3 03 | Q4 03 | Q1 04 | Q2 04 | Q3 04 | Q4 04 | Oct 04 | Nov 04 | Dec 04 |
|--------------------------------------|------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|---------------|
| GDP growth | % yoy | 5.6 | 4.7 | 7.2 | 8.8 | 9.3 | 11.0 | 11.7 | 11.6 | -- | -- | -- |
| GDP growth | % yoy cum. | 5.6 | 5.1 | 6.0 | 6.8 | 9.3 | 10.3 | 10.8 | 11.0 | 11.1 | 11.1 | 11.0 |
| Industrial production | % yoy cum. | 7.0 | 6.3 | 6.5 | 7.1 | 13.0 | 14.4 | 15.7 | 15.6 | 16.1 | 15.8 | 15.6 |
| Agricultural production | % yoy cum. | 1.0 | -1.6 | 4.4 | 6.6 | 4.3 | 5.7 | 10.2 | 12.9 | 11.6 | 12.4 | 12.9 |
| CPI | % yoy eop | 29 | 29 | 28 | 25 | 22 | 18 | 15 | 18 | 15 | 14 | 18 |
| PPI | % yoy eop | 43 | 42 | 36 | 29 | 27 | 27 | 22 | 24 | 21 | 19 | 24 |
| Merchandise export (USD)* | % yoy | 31.1 | 19.6 | 21.4 | 25.1 | 27.7 | 36.9 | 44.2 | -- | 47.8 | 38.1 | -- |
| Merchandise import (USD)* | % yoy | 33.6 | 29.7 | 22.3 | 23.8 | 21.8 | 43.1 | 42.4 | -- | 34.6 | 37.0 | -- |
| Merchandise trade balance (NBB data) | USD m cum. | -171 | -410 | -714 | -1256 | -77 | -560 | -939 | -- | -1124 | -1780 | -- |
| Current account | USD m cum. | -39 | -53 | -189 | -527 | 133 | -115 | -228 | -- | -322 | -493 | -- |
| Current account | % GDP cum | -1.1 | -0.7 | -1.5 | -3.0 | 3.0 | -1.2 | -1.4 | -- | -1.8 | -2.2 | -- |
| International reserves | USD bn eop | 463 | 526 | 459 | 474 | 617 | 539 | 664 | 770 | 646 | 585 | 770 |
| Monetary Base | % yoy eop | 52 | 61 | 65 | 72 | 84 | 44 | 44 | 39 | 47 | 44 | 39 |
| Lending rate** | % p.a. aop | 47 | 41 | 33 | 31 | 29 | 24 | 18 | -- | 19 | 19 | -- |
| Exchange rate (official) | USD aop | 1960 | 2031 | 2082 | 2135 | 2156 | 2155 | 2161 | 2172 | 2170 | 2175 | 2173 |
| Exchange rate (official) | EUR aop | 2105 | 2311 | 2342 | 2541 | 2695 | 2617 | 2640 | 2816 | 2707 | 2817 | 2910 |

* Since 2003 – the data of the Ministry of Statistics and Analysis. Other external trade indicators – NBB data.

** Nominal rate of commercial banks for new loans for legal entities in national currency.

Sources: Ministry of Statistics and Analysis, NBB, own calculations.

| Key Economic Indicators | | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|--------------------------------|-----------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Nominal GDP* | BYR trn | 0.702 | 3.026 | 9.134 | 17.173 | 26.613 | 35.930 | 49.445 |
| Nominal GDP | USD bn | 7.1 | 5.4 | 8.9 | 12.1 | 14.5 | 17.4 | 22.9 |
| GDP growth | % yoy | 8.4 | 3.4 | 5.8 | 4.7 | 5.0 | 6.8 | 11.0 |
| Industrial production | % yoy | 12.4 | 10.3 | 7.8 | 5.9 | 4.5 | 7.1 | 15.6 |
| Agricultural production | % yoy | -0.7 | -8.3 | 9.3 | 1.8 | 0.7 | 6.6 | 12.9 |
| CPI | % yoy aop | 73 | 294 | 169 | 61 | 43 | 29 | 18 |
| CPI | % yoy eop | 182 | 251 | 108 | 46 | 35 | 25 | 14 |
| PPI | % yoy aop | 72 | 355 | 186 | 72 | 41 | 38 | 24 |
| PPI | % yoy eop | 197 | 245 | 166 | 41 | 42 | 29 | 19 |
| Exports (gs, USD) | % yoy | -10.8 | -8.5 | 17.6 | 10.4 | 8.6 | 26.9 | -- |
| Imports (gs, USD) | % yoy | -7.8 | -19.0 | 21.0 | 8.2 | 9.1 | 27.2 | -- |
| Current account | USD m | -1017 | -194 | -338 | -435 | -337 | -505 | -- |
| Current account | % GDP | -10.8 | -3.1 | -3.8 | -3.6 | -2.3 | -2.9 | -- |
| FDI (net) | USD m | 201 | 443 | 119 | 96 | 453 | 169 | -- |
| International reserves | USD m | 339 | 305 | 357 | 347 | 457 | 474 | 770 |
| Fiscal balance** | % GDP | -5.0 | -2.9 | -0.6 | -1.3 | -0.6 | -1.3 | -0.4 |
| Internal public debt | % GDP eop | 4.9 | 5.7 | 4.5 | 4.5 | 4.6 | 6.0 | 5.6 |
| External debt (total) | % GDP eop | 51 | 42 | 24 | 20 | 20 | 19 | 17 |
| Monetary base | % yoy eop | 102 | 204 | 52 | 225 | 32 | 51 | 42 |
| Exchange rate (official)* | USD aop | 151 | 572 | 1035 | 1394 | 1784 | 2075 | 2160 |
| Exchange rate (official)* | USD eop | 430 | 925 | 1213 | 1580 | 1920 | 2156 | 2170 |
| Spread*** | % aop | 224.0 | 128.2 | 44.4 | 0.8 | 0.0 | 0.0 | 0.0 |
| Spread*** | % eop | 301.9 | 189.1 | 2.8 | 0.2 | 0.0 | 0.0 | 0.0 |
| Exchange rate (official)* | EUR aop | -- | 270 | 651 | 1239 | 1690 | 2353 | 2686 |
| Exchange rate (official)* | EUR eop | -- | 323 | 1097 | 1392 | 1989 | 2695 | 2956 |

* On January 1, 2000 the Belarusian ruble was devalued (1:1000). All figures are given in "new" Belarusian rubles.

** The fiscal balances for 1996-1998 included quasi-fiscal financing through commercial banks. Negative values refer to fiscal deficits.

*** Spread between the black market and official (NBB) exchange rates.

Sources: Ministry of Statistics and Analysis, Ministry of Finance, NBB, own calculations.

Notes:

| | | | |
|------|--------------------|------|--------------------------|
| aop | average of period | mom | month-on-month change |
| avg | average | trn | Trillion |
| bn | billion | NBB | National Bank of Belarus |
| cum. | cumulative | p.a. | per annum |
| eop | end of period | yoy | year-on-year change |
| gs | goods and services | ytd | year-to-date |
| m | million | | |

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