

Belarusian Monthly Economic Review

- Individual entrepreneurs protest against new VAT regime in trade with Russia.
- Industrial output growth slowed down in January and inventories increased.
- In December imports grew in anticipation of the new regime of VAT payment.
- According to preliminary data, the consolidated budget was executed with a surplus in 2004.
- Money supply decreased by 10.1% in January.
- Belarusbank resumed giving loans in hard currency to households.

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Politics: Individual entrepreneurs protest against new VAT regime in trade with Russia

Individual entrepreneurs went on a one-day strike against VAT payment on February 10 that was caused by the change in the VAT payments regime (to be based on the country of destination) in trade with Russia from January 1, 2005. Earlier they were freed from paying VAT and instead paid the single tax. Now enterprises engaged in trade with Russia have to pay not only the single tax but also VAT of 18%. This will increase their operating costs and reduce profitability. The Belarusian government refused to make any concessions and grant tax breaks to individual entrepreneurs, as this would not be compatible with the ratified Agreement between Belarus and Russia. Individual entrepreneurs threatened to hold a national permanent strike and to cease all tax payments to the state.

Real sector: Industrial output growth slowed down

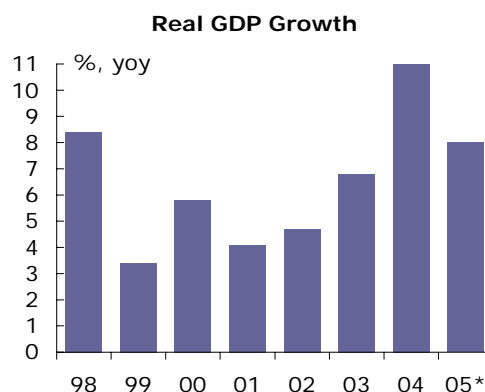
According to official data, GDP increased by 10.4% yoy in January 2005, which is 0.6 percentage points less than in 2004. The main reason for this slowdown is the decrease in the industrial output growth rate. Industrial output grew faster than in 2004 in only two branches (construction materials and fuel). Output growth in the construction materials industry was due to an increase in investments and the volume of construction works. Higher growth in the fuel industry was due to the installation of a new catalytic cracking facility at the Mozyr oil refinery, which led to higher output of oil products in a favorable environment of high demand.

In other branches of industry growth rates fell considerably. Many enterprises suspended merchandise delivery to Russia in January, which led to output reduction and increases in inventories. Inventories in industry amounted to 61.5% of the average monthly output as of February 1, 2005. This is 5.8 percentage points higher than in February 2004. Evidently, this is due to the new regime of indirect tax payment in trade with Russia.

Structural trends: Cross-subsidization in the energy sector has increased

Belarusian consumers are beginning to feel higher Russian gas prices. Gas prices for industrial enterprises went up by 8% from February 1. However, quite a few industrial enterprises kept their privileges (5–50% discount off the normal gas price). Since prices for imported gas increased more (by 18% due to the new VAT regime), gas sector profits will be squeezed. Gas prices for households will increase gradually (following President Lukashenko's order not to increase prices for utility and housing services by more than USD 5–6 a year), by 1.85% a month from February 10 to October 1. All in all gas

Population: 9.8 m
Industry/GDP: 26.8%
Agriculture/GDP: 8.9%
Investment/GDP: 20.7%
Export destination: Russia 47%, EU 37%
Import origin: Russia 68%, EU 20%



* Own estimates.

Source: Ministry of Statistics and Analysis.

will become 18% more expensive, corresponding to the increase in prices of imported Russian gas.

As households do not cover 100% of the gas price, the difference will be covered from gas sector profits. Thermal and electric energy prices for industrial enterprises went up by 15% from February 1. They will increase by 5.6 and 18%, respectively, for households between February 10 and October 1. Overall, cross-subsidization of households and a few selected enterprises and sectors is increasing.

Foreign trade: In December imports grew in anticipation of the new regime of VAT payment.

Merchandise exports amounted to USD 13.8 bn (60.1% of GDP) and imports were USD 16.4 bn (71.5% of GDP) in 2004. The merchandise trade deficit increased by 60.9% yoy, which was due to a considerable increase in December 2004 (by 252% yoy). Imports grew sharply especially from Russia (by 95% yoy) in December. Belarusian enterprises increased deliveries of Russian goods as they expected prices to go up due to the new regime of VAT payment. Imports of ferrous metals increased 2 times, machines and equipment - 2.5 times, chemical industry products – 1.8 times in December 2004 compared to December 2003. As a result, merchandise imports are likely to be lower in the beginning of 2005.

This increase in the merchandise trade deficit was only partially compensated by the surplus in trade in services and the positive balance of the 'revenues' account due to the receipt of a Russian loan in December 2004. We estimate that the current account deficit exceeded USD 800 m in 4Q04. This deficit was probably financed by an increase in current arrears of Belarusian enterprises for imported goods, as official reserves did not decrease and there was no substantial inflow of direct and portfolio investments in December.

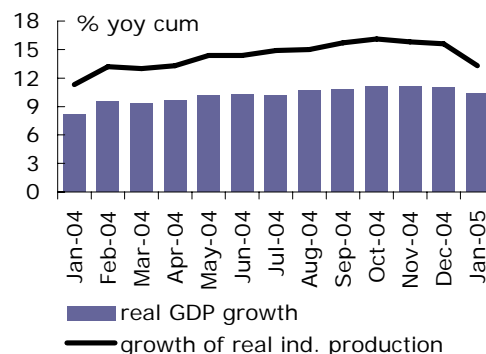
Public finance: The consolidated budget was executed with surplus in 2004

Consolidated revenues increased by 5.6 percentage points compared to January 2004 and amounted to 53.9% of GDP in January 2005. The revenues grew due to the inclusion of innovation funds in the budget. A considerable revenue increase was also due to the higher VAT revenues on goods imported from outside CIS in December 2004 (VAT on these import operations was paid in January 2005). Income tax revenues also went up considerably due to wage increases. Revenues from external trade operations also increased, which is partly due to increased exports of oil products.

The central budget was amended 16 times in 2004. In the process, the planned deficit was increased to 2.2% of GDP. However, according to preliminary data the actual deficit turned out to be much smaller at 0.1% of GDP in 2004. The consolidated budget was executed with surplus of 0.1% of GDP. Consolidated revenues amounted to BYR 22049 bn or 101.4% of the amended plan. Expenditures amounted to BYR 22013.3 bn or 97% of the plan. Higher revenues than expenditures are due to the surplus of the Social Security Fund and higher than expected VAT and profit tax revenues. Several ministries and budgetary organizations did not fully use the projected funds, which led to the formal failure to execute the expenditure part of the budget.

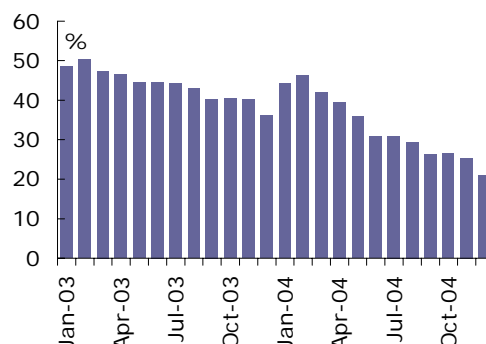
The government paid off all its debt to the International Monetary Fund on February 1. The IMF had provided Belarus loans in the total amount of more than USD 290 m before it stopped crediting the country in 1998 as Belarus failed to meet the condition to carry out economic reforms. It is expected that

GDP and Industrial Production



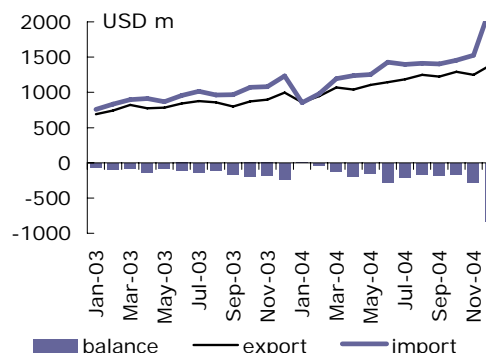
Source: Ministry of Statistics and Analysis.

The share of the Loss-making Enterprises



Source: Ministry of Statistics and Analysis Data.

Merchandise Trade Dynamics



Source: Ministry of Statistics and Analysis.

Contributions to Import and Export Growth

	2004 compared to 2003, %	
	Export	Import
Mineral products	40.0	31.4
Machinery and equipment	8.5	19.7
Transport	11.5	5.2
Chemical products	10.2	12.4
Textiles	2.6	1.4
Agricultural and food products	8.1	7.4
Base metals	9.1	18.0
Other	9.9	4.5
Total	100.0	100.0

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

the total amount of external financing of the state expenditures will exceed USD 350 m in 2005. This includes a Russian loan (USD 146 m), which will be given as compensation for the gas price rise, a loan from the Moscow city government (USD 200 m), a loan from Libya (USD 100 m) and a syndicated loan of the Austrian Raiffeisenbank.

Monetary policy: The money supply decreases and inflation slows down

The NBB tightened its monetary policy at the end of January. Taking into account reduced business activity at the beginning of the year, the NBB as a rule reduces money supply to cushion the consequences of the traditionally increased supply of money at the end of the previous year. The money base decreased by 10.1% mom in January. The main sources of this reduction were a fall in net foreign assets, an increase in deposits of the government in the NBB and the repayment of loans given to banks by the NBB.

The reduction of the money supply by the NBB had an impact on the liquidity of the banking system in late December 2004. By the beginning of January this liquidity problem was practically solved, but by the end of January excess reserves of commercial banks decreased again (by 39.3% mom). As a result, the reduction of the interbank market interest rates that occurred in early January did not last long, and the average interest rate in January remained practically at the same level as in December (21.7%). In spite of liquidity problems, banks (primarily state-owned) are required to meet the government's target to increase provision of credit to the real sector. That is why credits to economy increased by 2.5% mom in January.

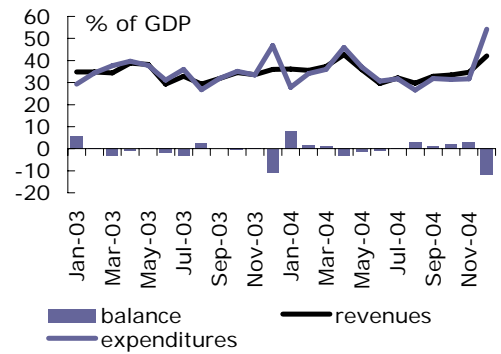
Reduction of the money base and high interest rates on ruble and hard currency deposits led to a reduction of cash in circulation (by 5.7% mom) in January, and to an increase in time ruble deposits and the population's purchase of hard currency in order to increase time hard currency deposits. At the same time, all types of deposits by legal entities decreased partly due to seasonal factors and partly due to a reduction in turnover capital. Probably, enterprises were paying off debts to Russian suppliers of goods imported in December. As a result, all monetary aggregates decreased in January. Ruble money supply went down by 3.3% mom, broad money decreased by 2.2% mom.

Consumer prices increased by 0.7% mom in January. The Belarusian ruble appreciated by 0.5% relative to the US dollar in February. As of February 28, the exchange rate was 2161 BYR/USD.

Banking sector: Belarusbank resumed giving loans in hard currency

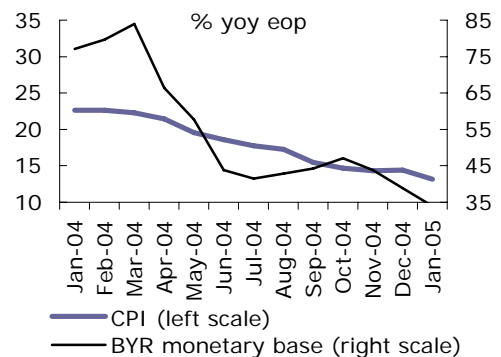
Belarusbank resumed giving hard currency loans to the population in February. However, interest rates on new hard currency loans went up by 2 percentage points on average compared to December 2004. The main reasons for the interest rate increase were a lack of credit resources in the banking system and the intention of Belarusbank to lower demand for hard currency loans. The Ministry of Economy intends to reduce the credit resources deficit in the banking system by attracting USD 1 bn from outside sources. USD 120 m of this amount should be the contribution to the statutory capital of the banks. However, the Belarusian banking sector has quite limited access to international credit markets, so it is unclear how this amount of money can be attracted from foreign sources.

Consolidated Budget*



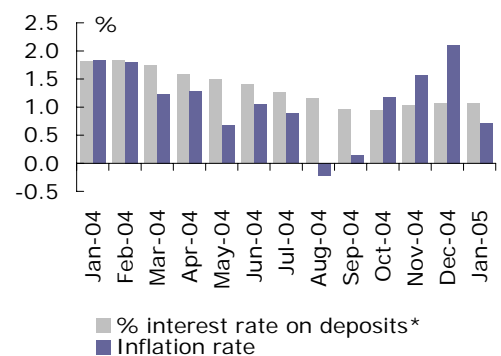
* Without Social Security Fund.
Source: Own calculations based on the Ministry of Statistics and Analysis and the NBB data.

Ruble Monetary Base and CPI



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

Monthly 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	Nov 04	Dec 04	Jan 05
GDP growth	% yoy	5.6	4.7	7.2	8.8	9.3	11.0	11.6	11.6	--	--	10.4
GDP growth	% yoy cum.	5.6	5.1	6.0	6.8	9.3	10.3	10.8	11.0	11.1	11.0	10.4
Industrial production	% yoy cum.	7.0	6.3	6.5	7.1	13.0	14.4	15.7	15.6	15.8	15.6	13.3
Agricultural production	% yoy cum.	1.0	-1.6	4.4	6.6	4.3	5.7	10.2	12.9	12.4	12.9	12.7
CPI	% yoy eop	29	29	28	25	22	18	15	18	14	18	13
PPI	% yoy eop	43	42	36	29	27	27	22	24	19	24	15
Merchandise export (USD)*	% yoy	31.1	19.6	21.3	25.0	27.7	36.9	44.6	42.2	40.3	38.3	--
Merchandise import (USD)*	% yoy	33.6	29.7	22.8	24.6	21.5	43.1	42.9	53.4	41.1	79.7	--
Merchandise trade balance (NBB data)	USD m cum.	-171	-410	-714	-1256	-86	-588	-1003	-2206	-1389	-2206	--
Current account	USD m cum.	-39	-53	-189	-527	133	-115	-228	--	-493	--	--
Current account	% GDP cum	-1.1	-0.7	-1.5	-3.0	3.0	-1.2	-1.4	--	-2.2	--	--
International reserves	USD bn eop	463	526	459	474	617	539	664	770	585	770	693
Monetary Base	% yoy eop	52	61	65	72	84	44	44	39	44	39	34
Lending rate**	% p.a. aop	47	41	33	31	29	24	19	18	19	18	--
Exchange rate (official)	USD aop	1960	2031	2082	2135	2156	2155	2161	2173	2175	2174	2172
Exchange rate (official)	EUR aop	2105	2311	2342	2541	2695	2617	2640	2810	2817	2911	2860

* 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	36.565	49.445
Nominal GDP	USD bn	7.1	5.4	8.9	12.1	14.5	17.7	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	24.0	38.3
Imports (gs, USD)	% yoy	-7.8	-19.0	21.0	8.2	9.1	27.1	41.4
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	50	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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