

Belarusian Monthly Economic Review

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- The fuel sector growth has slowed.
- Russia carries out a compensation investigation on sugar imports from Belarus.
- Lower growth rate of oil imports from Russia.
- The VAT revenue distribution mechanism was changed.
- The NBB's net foreign assets decreased.
- Negotiations took place on possible selling authorized banks to foreign investors.

Politics: Change of rules to free persons from criminal responsibility

The President of Belarus amended his edict that regulates the process of freeing persons from criminal responsibility. It applies to persons who committed crimes and caused damage to state property, to assets of legal entities in which the state has a share, or any other significant damage to state or public interests. Criminals can now be pardoned if they compensate for the damage done, return illegally acquired property to the state, or hand over to the state the tools and means that were used to commit the crimes. These measures apply only to the public and state sectors of the economy, which might witness about existing problems of adequate management in these sectors. Thus the amendments are supposed to solve these problems by strengthening the administrative controls and the direct role of the president in the staffing policy within the state sector of the economy.

Real sector: The fuel sector growth has slowed

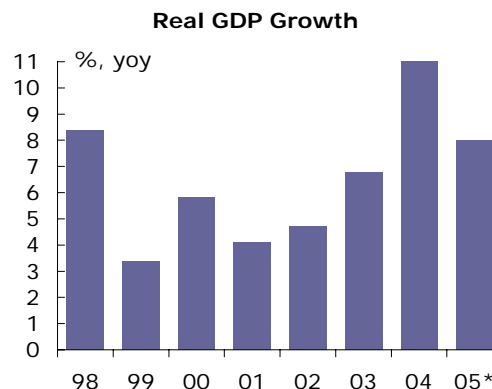
In Jan–Aug the GDP grew by 8.5% yoy. In August its growth rate dropped by 0.3 percentage points. The lower GDP growth rate was due to a considerable slowdown of growth in agriculture (from 11.6% yoy for Jan–Jul to 2.7% yoy for Jan–Aug). This development was caused by a poor growing season, resulting in a grain harvest that is worse than in 2004.

Industrial production rose by 9.7% yoy in Jan–Aug. Though the growth rate was slightly higher in a few sectors (light and food processing industries, machine building), the key sector of the Belarusian economy, the fuel industry, continued to grow more slowly. In Jan–Aug its output rose by 8.8% yoy, which is 2 percentage points less than for Jan–Jul. This was due to slower growth of the oil import volume from Russia (in 2004 it rose by 19.7%, while for Jan–Jul 2005 it grew by 10.8% yoy). The slower import growth was due to reduced crude oil production in Russia. Some Russian experts believe that in order to restore the former growth rate of oil extraction, new investment is needed in new oil fields. At the same time, high taxes on the oil companies make such investment quite unlikely in the near future. A further slowdown of Russian oil production will continue to lower the fuel sector growth rate in Belarus.

Structural trends: Russia carries out a compensation investigation on sugar imports from Belarus

Trade policy. The Russian Ministry of Economic Development decided to initiate a compensation investigation on white sugar imported from Belarus. Over the past years Belarus has become the main supplier of sugar to the Russian market with a share of about 75%. Sugar is imported into Russia on favorable terms within the framework of the single customs area. The Russian side believes that such policy damages their producers. This protectionist stance by Russia could lead to problems in the future workings of the common customs union.

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.

Nationalization. In September the arrears of the joint stock company "Minsk Porcelain Works" (BYR 1.3 bn as of March 1, 2005) to the government were restructured. For this purpose the state's share in the company's authorized capital was increased by issuing new shares to the state and to municipalities. The President issued an edict to transfer BYR 1.1 bn to the company out of central government funds. This again is proof of the continuing process of transferring private property to the state. This same scheme is used whenever an enterprise faces financial difficulties.

External trade: The Russian oil delivery growth rate is slowing

For Jan–Jul the merchandize export growth (19.1% yoy) remained higher than the import growth rate (1.1% yoy), which led to the merchandize trade surplus (USD 264.4 m) being maintained. The transition to the new VAT payment regime and the policy of import restrictions contributed to that. Another factor that added to the import slowdown was the slower growth of Russian oil imports to Belarus, which commenced at the beginning of the year. As the share of oil in total imports amounts to 24.2% and that of imports from Russia to 40%, the impact on imports is obvious.

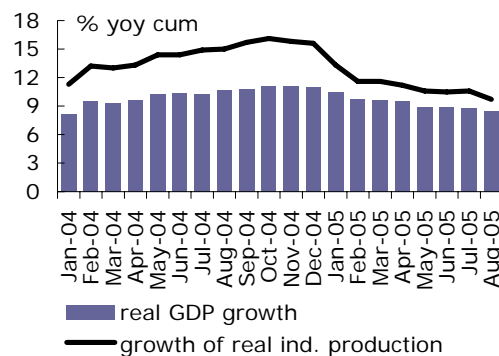
During the first half of 2005, the current account surplus amounted to USD 1 bn (7.5% of GDP). During the second quarter, its growth slowed due to the merchandize trade deficit (USD 15.1 m in the second quarter). At the same time, a considerable outflow of resources from the financial account of the item "other investment" was observed (from USD 607.4 m in the first quarter to USD 25.9 m in the second quarter). This is due to the fact that during the first quarter of 2005 Belarusian enterprises settled a considerable number of accounts payable to Russian residents, which had accumulated at the end of 2004. Thus by the second quarter of 2005 the shock to capital flows between Belarus and Russia caused by the change in the VAT payment regime had almost abated.

Public finance: Changes to the VAT revenue distribution mechanism

In August the growth rate of general government revenues was once again lower than the nominal GDP growth rate. The main reason for this is the VAT repayments to exporters to whom a zero rate applies. As a result, the share of the consolidated revenues in the GDP dropped by 1 percentage point in August. For Jan–Aug it amounted to 49.5% of GDP. The share of VAT revenues dropped by 0.2 percentage points to 9.3% of GDP. In spite of this transition to the new regime of VAT payment with Russia based on the country of destination contributed to the increase of VAT revenues by 1.4% of GDP compared to Jan–Aug 2004.

The president issued a decree to change the VAT revenue distribution between the central and local governments. To date the local administrations got from 24% to 100% of VAT on goods produced inside the country, and all VAT revenues paid on imports went to the central government (since January 1, 2005). VAT reimbursement to exporters from the local administrations was done in proportion to the normative payments. As a result, many local authorities faced a lack of funds to repay VAT sums on goods sold to Russia. The new edict stipulates that all VAT revenues will be accumulated in one treasury account. The local administrations will then receive 30.34% (excluding any funds to be repaid to exporters to whom a zero VAT rate applies). These funds will be distributed among the regions according to new norms calculated on the basis of planned expenditures by the local authorities,

GDP and Industrial Production



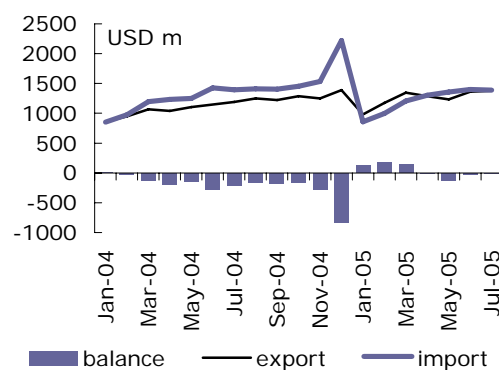
Source: Ministry of Statistics and Analysis.

Contribution to industrial output growth

	Jan-Aug 2005	
	Growth rate*	Contribution**
Industry	9.7	9.7
including industries:		
electric power	-5.2	-0.4
fuel	8.8	1.8
ferrous metallurgy	9.1	0.4
chemical and petrochemical industry	5.1	0.6
machinery and metalworking	14.5	2.9
logging, woodworking, pulp and paper	7.2	0.3
building materials	8.9	0.3
light	4.6	0.2
food	13.9	1.9
other	15.5	1.8

* % yoy; ** percentage points. Source: Own calculations based on the Ministry of Statistics and Analysis data.

Merchandise Trade



Source: Ministry of Statistics and Analysis.

Balance of Payments

	1 st half of 2005	
	USD m	growth, USD m, yoy
Current account	969.0	1075.5
Goods	489.3	1057.9
Services	434.5	80.0
Capital account	17.5	-11.0
Financial account	-938.2	-976.4
Direct investments	82.7	13.7
Other investments	-633.3	-643.3
Reserve assets	-383.6	-336.5
Errors and omissions	-48.3	-88.1

Source: NBB.

which vary by region between 2.8% and 5.96% of the sum "cleaned" from VAT refunds. These changes should help to better balance local revenues and expenditures and hence have a positive effect.

Monetary policy: The NBB reduced its net foreign assets

The great increase of the money supply in Jun–Jul (its growth accelerated from 22.6% yoy in May to 49.8% yoy in July) led to an increase in the demand for foreign currency. At the same time the hard currency supply growth slowed due to lower hard currency revenues. In order to maintain the exchange rate, the NBB sold hard currency (its net foreign assets fell by USD 48.6 m in August). As a result, the monetary base decreased by 1.5% mom in August. In annual terms, its growth rate reduced to 47.5% yoy.

The decrease in the money supply was not enough to mitigate the situation of excessive liquidity in the banking sector. To solve this problem the NBB continued selling its own short-term bonds. Furthermore this situation affected banks to increase crediting of the economy considerably. For the first time since February 2005 an accelerated bank loan growth was observed. In August loans increased by 5.7% mom or by 41.5% yoy in annual terms (39.8% yoy in July). Due to the increased supply of credit resources from the banks, the interest rates for Belarusian rubles continued to fall, while hard currency interest rates remained practically unchanged, resulting in a reduced spread between them.

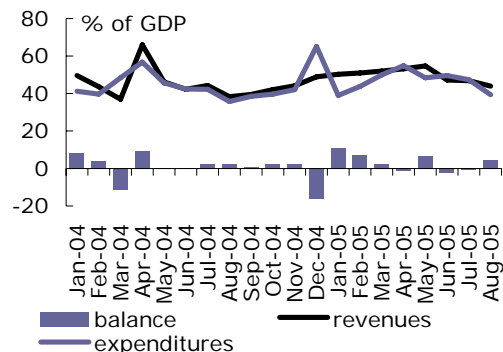
The reduction of the interest spread between ruble and hard currency instruments led to an accelerated growth of household deposits in hard currency, while the growth rate of ruble time deposits by households remained fairly stable (65% yoy in August), because the real interest rates in Belarusian rubles remained positive. Due to a substantial overall growth of household savings the amount of money in circulation decreased by 4.6% mom in August. Ruble money also decreased by 0.9% mom in August while broad money went up by 0.7% mom.

The seasonal reduction of food prices led to a decrease of consumer prices in August by 0.3% mom. In annual terms inflation amounted to 9.8% yoy. In September, the Belarusian ruble appreciated by 0.05% vis-à-vis the US dollar. On September 30, the exchange rate was 2150 BYR/USD.

Banking sector: Negotiations concerning the possible sale of authorized banks

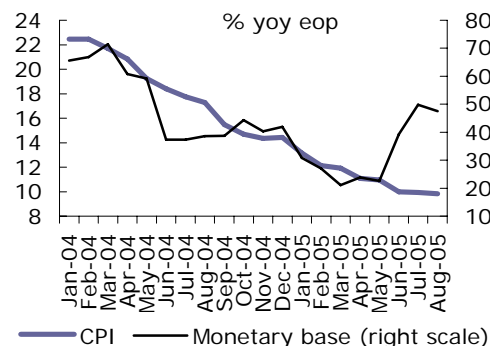
The Chairman of the Board of the NBB announced that the NBB is conducting negotiations with five foreign banks concerning the sale of controlling stock in Belarusian banks. Authorized banks are also included in these negotiations. These negotiations were probably initiated because banks got the order to attract USD 1 bn of investment, including USD 120 m in foreign direct investment in the authorized capital of the so called authorized banks. However, the possibility of selling the controlling stock of any bank was announced for the first time. This may be interpreted as a sign that the NBB desires a future increase of the share of foreign investment in the Belarusian banking system, which would have positive effects on the banking sector and on the country as a whole.

Consolidated Budget*



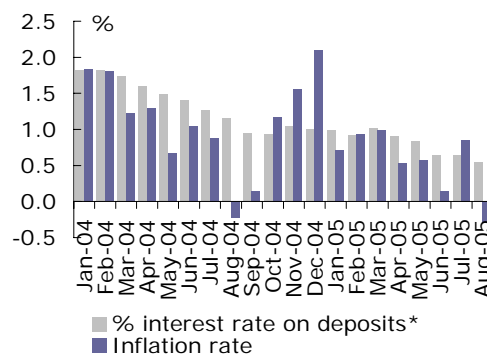
* 2004 – without innovation funds.
Source: Own calculations based on the Ministry of Statistics and Analysis and the NBB data.

Monetary Base and CPI



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

Monthly Inflation and Interest Rates



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

Economic Trends		Q3 03	Q4 03	Q1 04	Q2 04	Q3 04	Q4 04	Q1 05	Q2 05	Jun 05	Jul 05	Aug 05
GDP growth	% yoy	7.2	8.8	9.3	11.0	11.6	11.6	9.6	8.3	--	--	--
GDP growth	% yoy cum.	6.0	6.8	9.3	10.3	10.8	11.0	9.6	8.9	8.9	8.8	8.5
Industrial production	% yoy cum.	6.5	7.1	14.0	14.8	15.7	15.9	11.4	10.3	10.3	9.6	9.7
Agricultural production	% yoy cum.	4.4	6.6	5.0	5.7	11.4	12.6	12.5	10.1	10.1	11.6	2.7
CPI	% yoy eop	28	25	22	18	15	14	12	10	10	10	10
PPI	% yoy eop	36	29	27	27	22	24	14	12	12	11	11
Merchandise export (USD)*	% yoy	21.3	25.0	27.7	36.9	44.6	42.2	21.8	17.9	19.1	15.9	--
Merchandise import (USD)*	% yoy	22.8	24.6	21.5	43.1	42.9	53.4	0.5	3.3	-2.2	-0.9	--
Merchandise trade balance (NBB data)	USD m cum.	-714	-1256	-58	-541	-931	-2066	533	-15.0	--	--	--
Current account	USD m cum.	-131	-424	164	-58	-186	-1043	762	969	--	--	--
Current account	% GDP cum	-1.0	-2.4	3.7	-0.6	-1.1	-4.6	12.2	7.5	--	--	--
International reserves	USD bn eop	459	474	617	539	664	770	975	1130	1130	1225	1124
Monetary Base	% yoy eop	52	51	71	37	39	42	21	39	39	50	48
Lending rate**	% p.a. aop	33	31	29	24	19	18	19	15	14	14	--
Exchange rate (official)	USD aop	2082	2135	2156	2155	2161	2173	2164	2151	2150	2150	2150
Exchange rate (official)	EUR aop	2342	2541	2695	2617	2640	2810	2840	2713	2619	2590	2642

* 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	7.0	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	-394	-311	-424	-1043
Current account	% GDP	-14.9	-3.6	-3.9	-3.2	-2.1	-2.4	-4.6
FDI (net)	USD m	201	443	119	96	453	170	168
International reserves	USD m	339	305	357	347	457	474	770
Fiscal balance**	% GDP	-1.4	-2.9	-0.6	-1.6	-0.2	-1.6	0.1
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 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		