

## Belarusian Monthly Economic Review

- The draft of the Constitutional Act of the Union of Belarus and Russia received preliminary approval.
- Services contributed most to GDP growth in the third quarter of 2005.
- The state became the sole owner of Beltransgaz.
- Local governments have fiscal surpluses as a consequence of the new VAT distribution mechanism.
- The NBB financed the government.
- More state interference in investment crediting.

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### Politics: Preliminary approval of the draft of the Constitutional Act of the Union of Belarus and Russia

The bilateral Commission for drafting the Constitutional Act of the Union of Belarus and Russia met on October 20. Work on the draft has accelerated. The parties decided to put the draft act on the agenda of the session of the Highest State Council, which is to be held on November 15. If the two presidents adopt the Constitutional Act, Belarus and Russia will hold referenda on its approval in 2006. At the same time the countries still have certain disagreements on the structures of the executive bodies of the Union State and on the necessity of the president position in the Union State. Intensification of work on the draft of the Constitutional Act may significantly affect both the political and economic relations between the two countries very soon.

### Real sector: Services contributed most to GDP growth in the third quarter of 2005

In Jan–Sep GDP increased by 8.7% yoy. During the third quarter it went up by 8.5% yoy, which is 0.2 percentage points more than during the second quarter. GDP growth accelerated in the third quarter in spite of slower industrial growth and a recession in agriculture. Services (primarily trade) contributed most to the GDP increase. The growth in trade was stimulated by high consumer demand, which in turn was the caused by the high growth rate of real household incomes.

The biggest growth rate declines in industry occurred in the fuel, ferrous metals and petrochemical industries, with growth rate decreases of 8.3, 6.2 and 3.2 percentage points respectively. In some smaller sectors the growth rates rose a little, without, however, affecting the tendency of slowing industrial output growth. During the third quarter, its growth rate was 8.6% yoy, which is 0.7 percentage points less than during the previous quarter.

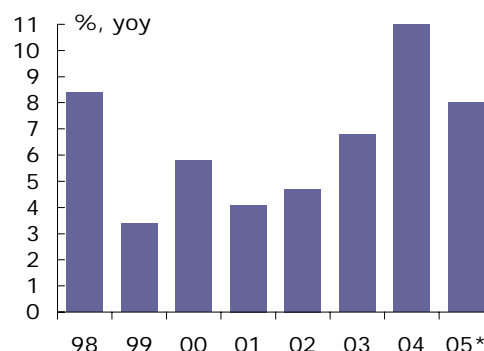
### Structural trends: The “Beltransgaz” stock was repurchased and transferred to the state

**Nationalization.** At a Beltransgaz shareholders' meeting it was decided to buy all shares owned by physical entities at a nominal price and transfer them to the state free of charge. As a result, the state will own 100% of this company. This measure was necessary in order to continue the negotiations with Gazprom on setting up a joint Belarusian Russian venture, in which both countries can participate on equal terms. Though the physical entities owned just a small fraction of the share capital of Beltransgaz (0.103%) this ownership impeded the negotiation process.

**Protectionism.** At a meeting called to discuss brewery barley purchases the president of Belarus banned the import of this product. He compared its import to an attempt to damage Belarusian agriculture. This import substitution practice can

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%

Real GDP Growth



\* Own estimates.

Source: Ministry of Statistics and Analysis.

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be interpreted as a measure to save resources for the purchase of imported goods. The government estimates that it could save USD 150–200 m annually. However, due to the lower quality of Belarusian barley this ban could lower the competitiveness of Belarusian beer and lead to increased beer imports.

**External trade: The national program of export development for 2006–2010 was adopted**

In August, the merchandise trade deficit amounted to USD 147.8 m. This is due to slowing export growth and an acceleration of merchandise import growth. However, in Jan–Aug export growth rate (17.7% yoy) was higher than import growth rate (2.5% yoy) and merchandise trade balance remained positive (USD 93.8 m). Oil products, potash fertilizers and ferrous metals took the biggest share of exports. The share of these goods in the export structure reached 58%, emphasizing that low-technological goods still dominate Belarusian exports.

To increase the share of high-tech and science-intensive goods in the structure of export the government drafted the National Program for Export Development, which was approved by the Presidium of the Council of Ministers. This document stipulates that the share of hi-tech goods in the structure of Belarusian exports should reach 37% by 2010. According to the Program, the biggest contributors should be pharmaceuticals, the tool making sector and microelectronics, which taken together only represent 4.3% of exports now. However, the Program does not define the steps needed for reaching its lofty goal. Moreover, to increase the export of high-tech Belarusian products will require major changes in the structure of the Belarusian economy.

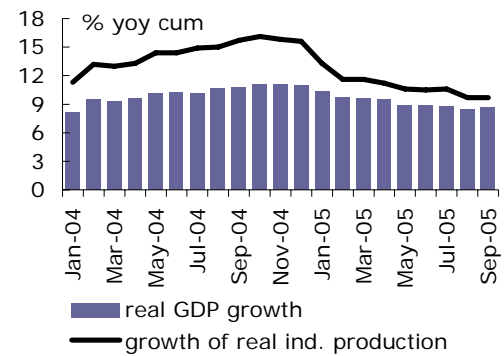
**Public finance: Changes to the VAT revenue distribution mechanism**

In August, the growth rate of the consolidated revenues still exceeded that of the consolidated expenditures. In Jan–Aug consolidated revenues amounted to 49.5% of GDP and expenditures was equal to 46.7% of GDP (45.3 and 43.5% of GDP a year earlier). The fiscal surplus amounted to 2.9% of GDP, which is 1.2 percentage points more than for the same period last year. Unlike in earlier months, the execution of local budgets improved. The fiscal surplus of local governments was 0.2% of GDP for Jan–Aug, due to changes in the VAT distribution between the central and local governments. Also, a sound fiscal stance allowed the government to increase its deposits by BYR 195 bn in August.

In October, the president issued edicts to revise certain figures of the central budget for 2005. Expenditures were increased by BYR 57.6 bn. BYR 50 bn of this sum were directed towards fees and contributions to increase the authorized capital of Belinvestbank and BYR 7.6 bn will be state loans to pay off overdue debts of the company ‘Belmedpreparaty’. These additional expenditures will be financed by issuing government securities for BYR 50 bn and by decreasing government deposits by BYR 7.6 bn, which will increase the limit of the central government’s fiscal deficit to 1.9% of GDP.

The Ministry of Finance estimates that by the end of the year the budget can be revised again. Both revenues and expenditures are expected to be increased by BYR 1 trn. Additional revenues are expected due to the better financial status of enterprises, the favorable external demand and the new mechanism of VAT payment in trade with Russia. These revenues will be directed to increase wages and to support industrial enterprises.

**GDP and Industrial Production**



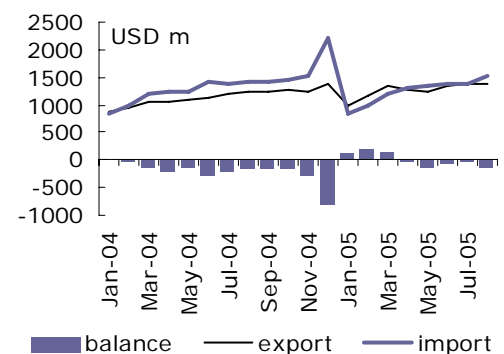
Source: Ministry of Statistics and Analysis.

**Contribution to industrial output growth**

	Jan-Aug 2005	
	Growth rate*	Contribution**
Industry	8.6	8.6
including industries:		
electric power	-7.4	-0.5
fuel	2.1	0.3
ferrous metallurgy	3.4	0.2
chemical and petrochemical industry	3.5	0.4
machinery and metalworking	14.1	3.0
logging, woodworking, pulp and paper	8.7	0.4
building materials	7.8	0.3
light	7.6	0.4
food	15.4	2.3
other	13.8	1.9

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

**Merchandise Trade**



Source: Ministry of Statistics and Analysis.

**Structure of Merchandise Trade in Jan-Aug**

	weight, %	
	exports	imports
Machinery, equipment and means of transport	20.5	21.8
Mineral products	33.5	33.2
Ferrous and nonferrous metals	8.2	12.0
Chemical products	15.5	12.8
Woodworking, pulp and paper	5.6	2.8
Food	8.5	11.5
Other products	8.2	5.9
<b>Total</b>	<b>100.0</b>	<b>100.0</b>

Source: Ministry of Statistics and Analysis.

**Monetary policy: The NBB finances the government by purchasing government bonds**

In the beginning of September in spite of liquidity surplus in the banking system the NBB continued to increase money supply to further stimulate crediting and lower interest rates. To this end the NBB actively refinanced commercial banks in September (13.4% mom growth). The net foreign assets of the NBB rose by 3.8% mom due to purchases of hard currency on the domestic market and increased government deposits in foreign currency. Hence, the money base increased by 4.4% mom in September. In annual terms, its growth reached 49.6% yoy (47.5% yoy in August).

To withdraw excessive liquidity the NBB still sold short-term NBB bonds (BYR 63.9 bn during the month). At the same time though having sufficient funds on hand, the banks lowered the growth rate of crediting, because the level of outstanding loans was too high and the demand for short-term loans was saturated. Thus, loans to the economy rose by 1.9% mom in September. In annual terms, crediting decreased, reaching 35.1% yoy (41.5% yoy in August). 70% of the increased outstanding loans were long-term bank loans. Since the risks of long-term loans are quite high they were issued mainly by the authorized banks, which followed the resolutions of the government. This caused the Belarusian ruble loan interest rates to remain practically unchanged. Hard currency loan interest rates continued to increase due to the stable exchange rate. The situation with deposit interest rates was similar. This interest rate situation caused enterprises and households to increase both ruble and hard currency deposits, which increased the cash in circulation by 4.7% mom in September. Ruble money rose by 3.5% mom and broad money by 2.7% mom.

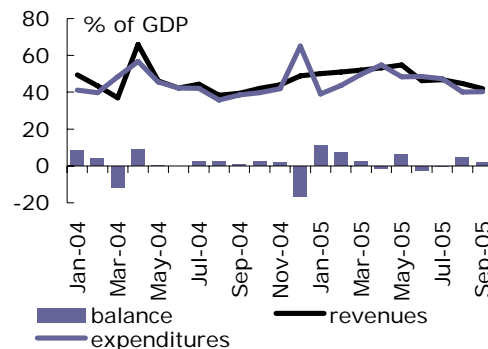
In October the NBB will have to return to the practice of financing the government in order to comply with a presidential edict concerning changes in the Belinvestbank ownership. Newly issued shares of the bank will be transferred to the government, which in turn will issue long-term bonds to the bank. The NBB is obliged to buy these bonds from Belinvestbank by November 1. This operation is equivalent to direct financing by the government and can thus have a negative impact on the country's monetary policy.

The high demand for national currency and the seasonal price drop of food products caused the small increase of consumer prices in September of 0.1% mom. In October, the Belarusian ruble appreciated against the US dollar by 0.05%. As of October 31, the exchange rate was 2149 BYR/USD.

**Banking sector: More investment crediting by the state**

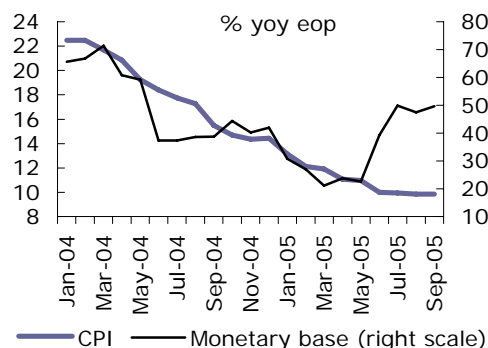
In October, the structure of ownership and the status of Belinvestbank, which is one of the authorized banks, were changed by a presidential edict. To date the NBB had owned the biggest share of the bank (41.7%). The edict stipulates that the government should get a controlling share. It also states that the bank will have a promotional status, which means that it must issue loans to finance investment activities to the extent of at least 25% of its overall assets. Moreover, the edict orders the government to transfer at least USD 10 m per year to the authorized fund to the bank and that the bank must grant at least USD 100 m of loans per year to finance government sponsored investment programs between 2006 and 2012. All this indicates that the government is increasing its role in investment field, because alternative sources of investment for the Belarusian economy are at present practically absent.

**Consolidated Budget\***



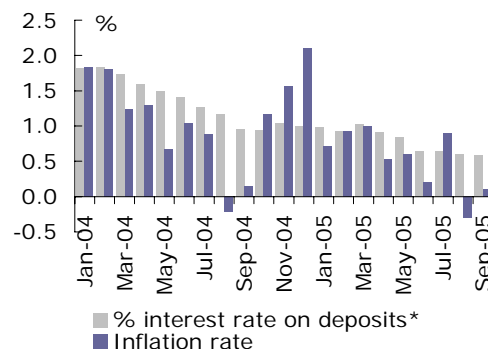
\* 2004 – without innovation funds.  
Source: Own calculations based on the Ministry of Statistics and Analysis and the NBB data.

**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		Q4 03	Q1 04	Q2 04	Q3 04	Q4 04	Q1 05	Q2 05	Q3 05	Jul 05	Aug 05	Sep 05
GDP growth	% yoy	8.8	9.3	11.0	11.6	11.6	9.6	8.3	8.5	--	--	
GDP growth	% yoy cum.	6.8	9.3	10.3	10.8	11.0	9.6	8.9	8.7	8.8	8.5	8.7
Industrial production	% yoy cum.	7.1	14.0	14.8	15.7	15.9	11.4	10.3	9.7	9.6	9.7	9.7
Agricultural production	% yoy cum.	6.6	5.0	5.7	11.4	12.6	12.5	10.1	3.0	11.6	2.7	3.0
CPI	% yoy eop	25	22	18	15	14	12	10	10	10	10	10
PPI	% yoy eop	29	27	27	22	24	14	12	11	11	10	10
Merchandise export (USD)*	% yoy	25.0	27.7	36.9	44.6	42.2	21.8	17.4	--	16.1	10.5	--
Merchandise import (USD)*	% yoy	24.6	21.5	43.1	42.9	53.4	0.6	3.3	--	-0.6	7.7	--
Merchandise trade balance (NBB data)	USD m cum.	-1256	-58	-541	-931	-2066	533	-15	--	520	400	--
Current account	USD m cum.	-424	164	-58	-186	-1043	762	969	--	1109	1086	--
Current account	% GDP cum	-2.4	3.7	-0.6	-1.1	-4.6	12.2	7.4	--	7.1	5.9	--
International reserves	USD bn eop	474	617	539	664	770	975	1130	1189	1225	1124	1189
Monetary Base	% yoy eop	51	71	37	39	42	21	39	50	50	48	50
Lending rate**	% p.a. aop	31	29	24	19	18	19	15	14	14	13	--
Exchange rate (official)	USD aop	2135	2156	2155	2161	2173	2164	2151	2150	2150	2150	2151
Exchange rate (official)	EUR aop	2541	2695	2617	2640	2810	2840	2713	2623	2590	2642	2638

\* 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		