

# BELARUSIAN MONTHLY ECONOMIC REVIEW



No. 4 (55)  
April  
2007

- Output decline in food industry.
- Foreign oil extraction agreements have been concluded.
- Belarus and Russia agreed on foreign trade conditions.
- The NBB restricts money supply.
- The state share in 'Belvnesheconombank' will be sold to the Russian 'Vnesheconombank'.

## Politics: The search for new foreign partners

In March, a seminar was held in Minsk within the framework of the European neighborhood policy. The event was organized jointly by the Belarusian Parliament and the Parliamentary Assembly of the OSCE. At the seminar, opportunities for cooperation between the EU and Belarus had been discussed. However, so far no substantial progress in bilateral relations has been achieved. Moreover, at the end of March the EU has extended the visa ban for 36 top officials from Belarus.

In March, Belarusian officials made several visits abroad. In particular, Belarus' delegation chaired by President Lukashenko, has visited the United Arab Emirates, while Prime-Minister Mr. Sidorski, and State Secretary of Security Council, Mr. Sheiman chaired delegations to Azerbaijan and Venezuela, respectively. During these visits, possibilities for cooperation in oil production, foreign trade and investment have been discussed. It appears that the Belarusian authorities continue their search for partners abroad other than Russia and the EU in order to enhance foreign economic competitiveness.

## Real sector: Output decline in food industry

In Jan-Feb, the rate of GDP growth decreased to 9% yoy. The major reason were problems in the manufacturing sector, where the rate of growth went down to 6.9% yoy. As for particular branches, a decline was registered in power industry (due to the mild winter of 2006/2007), fuel industry (due to the unresolved issues related to oil supply), and food industry. In the latter, output decline occurred because of the sharp reduction of sugar production – by 56.7% yoy in Jan-Feb following a decrease of its exports to Russia.

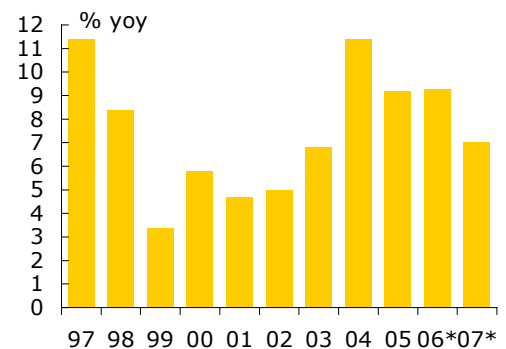
Industrial output growth was mainly driven by the sectors oriented towards the domestic market. Relatively high rates of growth were recorded in construction materials industry (due to fast increase of investment) and in some machine-building industries producing goods similar to ones whose import the government of Belarus attempts to restrict. The decline in food and fuel industries has demonstrated a high sensitivity of the Belarusian economy to foreign trade shocks. It follows that the opportunities for economic growth appear to be limited until the foreign trade problems are resolved.

## Structural trends: oil extraction agreements with foreign countries have been reached

**Energy sector:** The negotiations held between the prime-ministers of Azerbaijan and Belarus ended with an agreement to permit oil extraction in Azerbaijan for the Belarusian company 'Belorusneft'. At the same time, the state-owned oil company of Azerbaijan has been allowed to operate in the Belarusian market. This company would supply oil for processing in Belarus and then export refined oil. Further, the visit to Venezuela has led to an agreement on the creation of Belarus-Venezuela joint venture for the development of Venezuela's oil fields. It is planned that the enterprise would annually extract up to 10 m tons of crude oil. These agreements are aimed at creating conditions for the diversification of oil

Population: 9.71 m  
Industry / GDP: 27.6%  
Agriculture / GDP: 7.5%  
Investment / GDP: 24.3%  
Export destination: Russia 35%, EU 46%  
Import origin: Russia 59%, EU 22%

Real GDP growth



\* Estimate for 2006 and forecast for 2007: IPM Research Center.  
Source: Ministry of Statistics and Analysis.

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supply to the domestic oil refineries and increase in their profitability. However, due to high transport costs the economic efficiency of these projects is doubtful.

### Foreign trade: Conclusion of Belarus-Russia foreign trade agreement

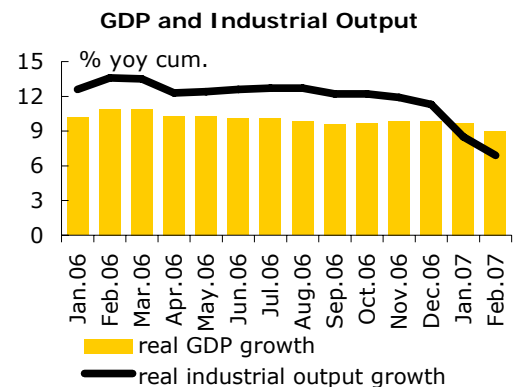
In January, the merchandise trade deficit amounted to USD 362.5 m (in contrast to a surplus of USD 36.3 m in January 2006). The volume of exports has not changed because of the sharp (by 37.6% yoy) decrease of exports of oil products. Hence, exports to the EU countries decreased by 24.6% yoy, leading to a decrease in merchandise trade surplus with the EU to USD 24.5 m (USD 446.0 m a year before). Exports of oil products decreased because the terms and conditions of supply of oil from Russia to the Belarusian refineries still have not been settled. Accordingly, the volume of imports of crude oil from Russia decreased (by 48.0% yoy), thus contributing to reduction of merchandise trade deficit with this country to USD 305.8 m (USD 413.8 m a year ago). At the same time, imports from the EU have increased almost twice due to growing supplies of rolling mills, agricultural machinery, tractors, and motor cars. As a result, total imports increased by 29.5% yoy, thus determining the state of merchandise trade balance in January. Nevertheless, it is not very likely that the dynamics observed in January could be treated as a trend since there is an adjustment to the new terms of trade underway.

There is certain influence to be observed on the developments in foreign trade in 2007 resulting from the cooperation agreement on trade and commerce concluded with Russia in March. This agreement sets the conditions of the mutual access to the national markets for government procurement and also regulates a range of issues related to transit and collection of indirect export and import taxes. Additionally, Belarus has also assumed obligations to abolish a number of barriers to access of certain goods from Russia to the Belarusian market, and also some export subsidies and subsidies for the use of domestic goods instead of imported ones. It is also reserved that Belarus shall not use restrictions and subsidies prohibited within the framework of the WTO. In general, it appears that Belarus would be forced to abandon its protectionist policies in trade with Russia. It is expected that following this agreement imports from Russia would be growing annually by up to USD 500 m, as it is estimated by Russian experts.

### Public finance: Changes in the taxation system

In March, some measures have been adopted to smooth down the consequences of the energy price hike for the real sector. First, for the enterprises providing housing and communal services VAT allowance has been granted. Most likely, this has been determined by a sharp accumulation of energy payment arrears (by 3.2 times as against the beginning of the year). Second, VAT allowance and similar measures provided for the payment of other taxes may also be granted to industrial enterprises. The funds saved as a result of these preferences are to be directed to local budgets (15%) and to finance innovation activities set in the business plan (85%).

Additionally, the government made steps to expand the scope of simplified taxation system. Prior to that, the system has not been used widely because of the high tax rates and advance tax payment. It is now expected that the criteria for the use of the new system – the average number of workers less than 100 (in contrast to 15 before) and the volume of annual revenue less than BYR 2 bn – along with the abolishment of the advance payment requirement, could jointly increase the attractiveness of small-scale entrepreneurship with setting up



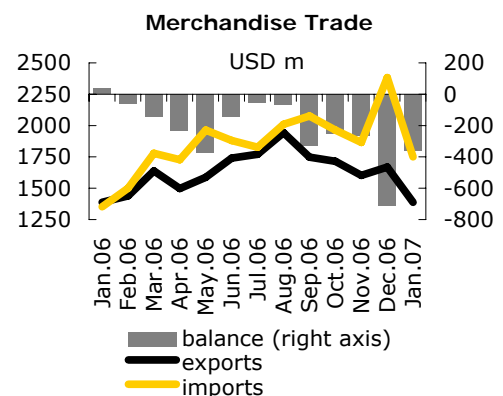
Source: Ministry of Statistics and Analysis.

### Contribution to Industrial Output Growth

Branches of industry:	Jan-Feb 2007	
	Growth rate*	Contribution**
Electric power	-6.7	-0.7
Fuel	-1.6	-0.3
Ferrous metallurgy	7.6	0.4
Chemical and petrochemical industry	9.2	1.1
Machinery and metalworking	14.1	3.0
Logging, woodworking, pulp and paper	4.9	0.2
Building materials	21.6	0.6
Light	7.4	0.3
Food	-4.7	-0.7
Other	28.5	3.0
<b>Industry, total</b>	<b>6.9</b>	<b>6.9</b>

\* % yoy, \*\* percentage points.

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



Source: Ministry of Statistics and Analysis.

### Trade Balance

USD m	Jan 2006	Jan 2007	change
<b>Total:</b>			
exports	1387.7	1387.8	0.1
imports	1351.4	1750.3	398.9
balance	36.3	-362.6	-398.9
<b>Russia:</b>			
exports	455.4	563.2	107.8
imports	869.2	869.0	-0.2
balance	-413.8	-305.8	108.0
<b>Non-CIS:</b>			
exports	823.6	693.7	-129.9
imports	395.8	763.3	367.5
balance	427.8	-69.6	-497.4

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

the company. For encouraging the development of entrepreneurial activity in small towns, tax rates in these localities have been cut by 2–2.7 times. While the number of tax receipts would probably decrease, it is unlikely that the simplified taxation system will lead to the reduction in the volume of tax receipts. Hence the switch to a new system would be beneficial for a limited number of small enterprises.

**Monetary policy: Restriction of money supply**

In February, the NBB has continued to conduct a rather tough monetary policy by limiting money supply in order to ensure stability at the currency market. Accordingly, the NBB has reduced its claims to commercial banks (by 0.7% mom). Thus demand and supply at the currency market stabilized, so the NBB was capable of purchasing currency at the market. At the same time, commercial banks began to increase their foreign assets by reducing the volume of excessive reserves in hard currency held at the NBB. That was the major reason behind the reduction of the net foreign assets of the monetary authorities by 3.2% mom. As a result, in February the monetary base decreased by 2.6% mom, while in annual terms its rate of growth went down to 37.9% yoy (38.5% yoy in January).

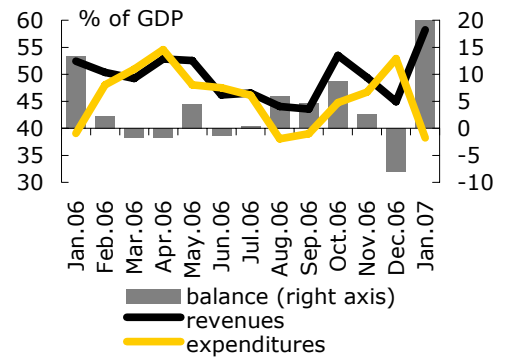
The restriction of money supply caused an interest rate increase at interbank and deposit markets. By increasing the attractiveness of savings, commercial banks were capable of securing the growth of their resource base needed to provide administratively-guided credit growth. In February the growth rate of banks' claims on economy increased (by 1.3 percentage points) to reach 61.4% yoy. Both population and enterprises increased the volume of ruble deposits, so their rate of growth amounted to 44.3% yoy (40.1% yoy in January). At the same time, in February there still was a tendency for increasing growth rate of foreign currency deposits – 38.6% yoy (33.9% yoy in January). Demand for cash had not changed substantially, but the growth rate of money in circulation slightly decreased to reach 27.4% yoy (30.1% yoy in January). Ruble money grew in February by 3.1% mom, while broad money – by 4.0% mom. In annual terms, the rates of growth of these indicators amounted to 36.0 and 36.8% yoy, respectively (34.5 and 34.3% in January).

The energy shock accelerated the increase of prices. In February consumer prices grew by 0.8% mom, or by 7.9% yoy (7.1% yoy in January). The exchange rate of the ruble did not change in March, remaining at the level of 2143 BYR/USD.

**Banking sector: Sale of government's and NBB's share in Belvnesheconombank**

According to the President's Edict signed in March, the state-owned holding of stock in 'Belvnesheconombank' will be sold to the Russian 'Vnesheconombank'. The stock amounts to 48.6% of the statutory capital of the bank, while the value of the transaction is expected to be about USD 21.5 m. 'Belvnesheconombank' is one of the six major banks authorized to service state programs. It occupies the 6<sup>th</sup> place in the Belarusian banking system according to the volume of assets and the resource base. It specializes in instruments of commercial financing and servicing of foreign trade transactions. The Belarusian authorities had announced before their readiness to sell the state-owned stocks of this and two other banks ('Paritetbank' and 'Mesztorgbank'). However, the agreements with potential investors had not been reached. Against the background of repercussions of gas and oil shocks, the sale of the state-owned holding of stock of 'Belvnesheconombank' could become a signal for foreign investors to create more friendly conditions for investing into the Belarusian banking system.

**Consolidated Budget**



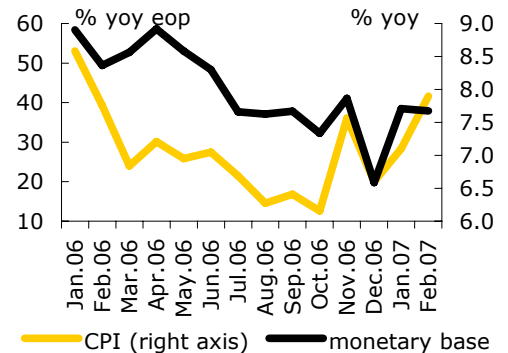
Source: calculations based on the Ministry of Statistics and Analysis data.

**Tax rates within simplified taxation system**

	Tax rate, %	
	Large city	Town with population less than 50,000*
Less than 15 employees, total revenue less than BYR 0.6 bn		
Those who pay VAT	8	3
Those who not pay VAT	10	5
From 15 to 100 employees, total revenue less than BYR 2 bn		
Those who pay VAT	8	3
Those who not pay VAT	--	--

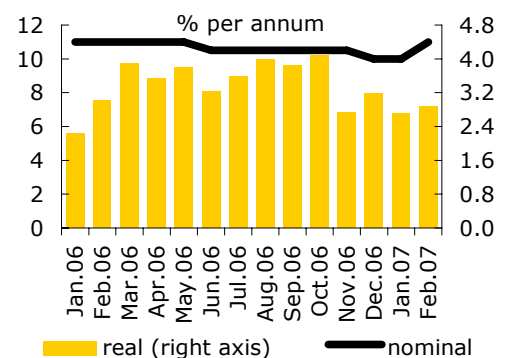
\* according to the list approved by the government.

**Monetary Base and CPI**



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

**Refinancing rate**



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

Economic Trends		Q1 05	Q2 05	Q3 05	Q4 05	Q1 06	Q2 06	Q3 06	Q4 06	Dec 06	Jan 07	Feb 07
GDP growth	% yoy	9.9	8.4	8.7	10.7	11.0	9.6	8.6	10.8	--	9.7	--
GDP growth	% yoy cum.	9.9	9.1	9.0	9.4	11.0	10.3	9.6	9.9	9.9	9.7	9.0
Industrial Production	% yoy cum.	11.7	10.3	9.7	10.5	13.5	12.6	12.2	11.3	11.3	8.5	6.9
Agricultural Production	% yoy cum.	12.5	10.1	3.0	2.1	10.1	6.9	2.2	6.1	6.1	7.0	5.2
CPI	% yoy eop	11.9	10.0	9.8	8.0	6.8	7.0	6.4	6.6	6.6	7.1	7.9
PPI	% yoy eop	14.2	12.1	10.5	10.2	8.3	8.1	8.0	8.5	8.5	22.4	22.6
Merchandise export (USD)*	% yoy	21.8	17.2	15.1	11.5	27.5	24.9	29.3	13.6	6.7	0.0	--
Merchandise import (USD)*	% yoy	0.6	3.6	7.8	-5.3	51.3	37.0	30.0	23.5	31.0	29.5	--
Merchandise trade balance (NBB data)	USD m cum.	452	345	43	-527	-136	-786	-1215	-2398	-2398	-365	--
Current account	USD m cum.	737	884	816	510	115	-289	-558	-1512	-1512	--	--
Current account	% GDP cum	12.2	6.7	3.7	1.7	1.5	-1.8	-2.1	-4.1	-4.1	--	--
International reserves	USD bn eop	975	1130	1189	1297	1290	1154	1155	1383	1383	1330	1303
Monetary base	% yoy eop	21	39	50	74	53	48	38	20	20	39	38
Lending rate**	% p.a. aop	19	15	14	12	12	11	12	12	12	12	13
Exchange rate (official)	USD aop	2164	2151	2150	2150	2151	2146	2142	2141	2140	2140	2142
Exchange rate (official)	EUR aop	2840	2713	2623	2558	2587	2694	2729	2761	2827	2782	2797

\* Growth rates in value terms (source: Ministry of Statistics and Analysis).

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

Sources: Ministry of Statistics and Analysis, NBB.

Key Economic Indicators		2000	2001	2002	2003	2004	2005	2006
Nominal GDP*	BYR trn	9.134	17.173	26.613	36.565	49.991	65.067	79231
Nominal GDP**	USD bn	8.7	12.1	14.5	17.7	23.1	30.2	36.9
GDP Growth	% yoy	5.8	4.7	5.0	7.0	11.4	9.4	9.9
Industrial production	% yoy	7.8	5.9	4.5	7.1	15.9	10.5	11.3
Agricultural production	% yoy	9.3	1.8	0.7	6.6	12.6	1.7	6.1
CPI	% yoy aop	168.6	61.1	42.6	28.4	18.1	10.3	7.0
CPI	% yoy eop	107.5	46.1	34.8	25.4	14.4	8.0	6.6
PPI	% yoy aop	185.3	72.1	41.4	37.5	24.1	12.1	8.3
PPI	% yoy eop	166.4	40.9	42.7	28.1	18.8	10.0	8.5
Exports (gs, USD)	% yoy	19.4	10.9	9.8	24.4	35.7	15.8	21.8
Imports (gs, USD)	% yoy	21.5	11.1	9.0	25.1	40.3	3.0	33.0
Current account	USD m	-338	-394	-311	-424	-1206	510	-1512
Current account	% GDP	-3.9	-3.2	-2.1	-2.4	-5.2	1.7	-4.1
FDI (net)	USD m	119	96	453	170	163	303	351
International reserves	USD m	357	347	457	474	770	1297	1383
Fiscal balance	% GDP	-0.6	-1.6	-0.2	-1.6	0.0	-0.6	2.2
Domestic public debt	% GDP eop	4.5	6.1	5.4	5.5	5.7	5.8	6.5
External debt (total)	% GDP eop	24.4	24.8	27.0	23.7	21.4	17.9	18.6
Monetary base	% yoy eop	52	225	32	50	42	74	20
Exchange rate (official)*	USD aop	1035	1394	1784	2075	2160	2154	2145
Exchange rate (official)*	USD eop	1213	1580	1920	2156	2170	2152	2140
Spread***	% aop	44.4	0.8	0.0	0.0	0.0	0.0	0.0
Spread***	% eop	2.8	0.2	0.0	0.0	0.0	0.0	0.0
Exchange rate (official)*	EUR aop	651	1239	1690	2353	2684	2681	2692
Exchange rate (official)*	EUR eop	1097	1392	1989	2695	2956	2550	2817

\* On January 1, 2000 the Belarusian ruble was denominated 1:1000. All figures for 1999 are given in 'new' Belarusian rubles.

\*\* For the period of 1999–2000, GDP in USD is calculated by using the market (unofficial) exchange rate (source: IPM Research Center).

\*\*\* Spread between the black market and official (NBB) exchange rates (source: IPM Research Center).

Sources: Ministry of Statistics and Analysis, Ministry of Finance, NBB, IPM Research Center.

#### Notes:

aop	average of period	gs	goods and services
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
m	million	ytd	year-to-date