

## Belarusian Monthly Economic Review

- Gas deliveries from Russia were temporarily halted on February 18.
- The Department for State Property Management of the Ministry of Economy was eliminated.
- Wage growth was much slower than productivity growth.
- In 2003 Belarus faced a worsening of the terms of trade with Russia.
- The budget arrears increased by 26.4% in January.
- Time ruble deposits increased substantially in January.

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### Politics: Gas deliveries from Russia were temporarily cut on February 18

At the session of the Council of Ministers of the Union of Belarus and Russia on February 10 the two sides failed to reach an agreement on the terms and the schedule for introducing a single currency. Neither was an agreement reached on the price and volume of Russian gas imports to Belarus. Since the gas delivery contract expired on February 18, Belarus began taking gas from the pipeline without Gazprom's consent. In response the Russian company cut off not just the gas deliveries, but also the gas being transited through the territory of Belarus. Russia's European partners had been warned about this decision beforehand. President Lukashenko's reaction to the Russian action was extremely negative. The Belarusian Ambassador in Moscow was recalled to Minsk for consultation. The Ministry of Foreign Affairs of Russia in turn issued a statement, in which it accused the Belarusian president of originating the conflict. On February 19, the gas deliveries to Belarus and the transit gas flow were re-established until the end of February, but an agreement with Gazprom was not reached.

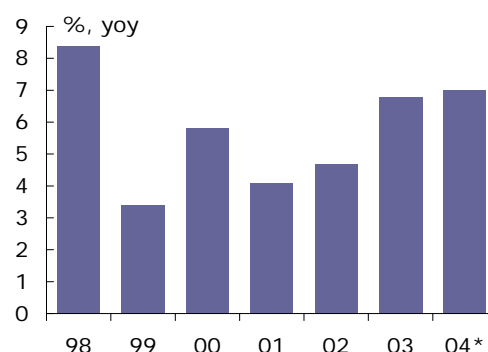
The structure of the government was changed: The Department for State Property of the Ministry of Economy was eliminated. This decision proves that accelerated privatization is unlikely in the near future. The decision could also endanger meeting the budgeted revenue targets and attracting foreign direct investment.

### Real Sector: The wage growth rate was much lower than the labor productivity growth

Production output and GDP growth continued to accelerate in most sectors of the economy in January. According to official statistics, the GDP grew by 8.2% yoy, and industrial production by 11.3% yoy in January. The outputs grew fastest in ferrous metals, the chemical and petrochemical sectors, machine building and metal processing. This was due to export increases in all these sectors. One of the factors that led to increased exports was the real depreciation of the Belarusian ruble against the Russian ruble. The large increase in the construction materials sector was due to a continuing increase in fixed capital investment. However, the output growth in 2003 went hand in hand with reduced employment and a slowdown of the increase of real wages. In fact, real wages fell in many branches of the economy. The largest wage reductions were experienced in the insurance, microbiology and petrochemical sectors (by 12.2%, 11.7% and 9% yoy respectively), while the salary of government authorities grew fastest (15.5% yoy). In 2003 the average real wage grew by 3% (3.9 percentage points less than in 2002). It lagged behind the labor productivity growth rate, i.e. the share of wages in the GDP decreased. The slow down of real wage growth was the main reason for the decrease in the growth rate of real incomes in Belarus in 2003.

Population: 9.8 m  
Industry/GDP: 25.5%  
Agriculture/GDP: 7.7%  
Investment/GDP: 18.6%  
Export destination: Russia 49%, EU 23%  
Import origin: Russia 66%, EU 15%

Real GDP Growth



\* Own estimates.

Source: Ministry of Statistics and Analysis.

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### Structural Trends: Gas prices and transit gas tariffs did not change yet

The contract with the Russian company "Transnafta" for gas deliveries was extended for another 3 days on February 29. The gas price remained unchanged at USD 46.68 per 1000 m<sup>3</sup>. Belarus and Russia are continuing to negotiate for gas deliveries at a price of USD 50 per 1000 m<sup>3</sup>. Also, Belarus hopes to raise the gas transit tariff from USD 0.55 to USD 1.02 per 1000 m<sup>3</sup> per 100 km. As the likely increase of the gas transit fee would not cover the losses caused by the expected higher gas prices for Belarus, the government decided to ask the Russian government for a loan in the amount of USD 200 m. Russia offered such a loan last year, but Belarus did not take it then.

Some food products (bread and bread products, milk, kefir, sour cream and cottage cheese) were again added to the list of "socially important goods", i.e. state regulation of prices of these goods was renewed. The aim is to keep the prices of these goods stable. However, the experience of similar actions in the past proves that price regulation is not effective. In fact, regulated prices tend to grow faster than consumer prices on the average. Also, price regulation usually results in shortages and in the deterioration of the quality of the goods regulated. Thus, over the medium term we can expect accelerated price growths for these food products.

### External Sector: Belarus faced a worsening of the terms of trade with Russia in 2003

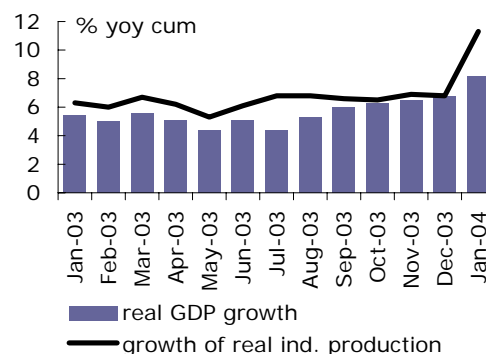
According to preliminary data, the merchandise trade deficit grew by 43.8% in 2003, exceeding USD 1.5 bn, or 8.8% of GDP. Intermediary goods contributed most to the growth of the trade deficit, as their imports grew much more than their exports. Despite the fact that exports of energy resources grew more than imports, the trade deficit of these goods increased, amounting to 45% of the entire intermediary goods trade deficit. An increased trade surplus of consumer goods partially compensated for this deficit, however the balance in investment goods got worse. This was due to increased imports of these goods caused by a growth in fixed capital investment. At the same time, the share of capital goods imports in the total of merchandise imports remained quite small (10.8%), which is evidence for the slow rate of modernization of fixed capital.

Trade with Russia still constitutes the largest share of Belarus' foreign trade. It should be noted that the price environment for this trade is quite unfavorable. In 2003 the average import price went up by 13.8%, while the average export price increased by 8.1%. Also, the export volume grew faster than the import volume (by 13.9% and 12.1% respectively). Thus, in 2003 Belarus faced a worsening of the terms of trade with Russia: more Belarusian goods at relatively lower prices were sold to Russia to pay for the imports from Russia.

### Public Finance: The budget arrears increased by 26.4% in January

According to preliminary data, the consolidated revenues (not counting the revenues of the Social Security Fund) amounted to 36.2% of GDP, which is 1 percentage point higher than in January 2003. There were some changes in the revenue structure of the general budget, partially related to amendments of the tax legislation. A reduction of the VAT rate led to reduced revenues from this tax: from 25.3% to 23.7% of consolidated revenues. Elimination of the reduced profits tax rate for small enterprises and increased excise taxes led to increases of the shares of these taxes in the consolidated revenues: from 8.2%

GDP and Industrial Production



Source: Ministry of Statistics and Analysis.

Dynamics of Real Wages and Production

	Growth rate in 2003, % yoy	
	Wage	Production
Industry	1.7	6.8
Agriculture	-3.4	6.8
Transport	4.2	11.4
Construction	5.8	12.3*
Trade and catering	-1.6	9.9**
Governance	13.3	--
The economy	3.0	6.8***

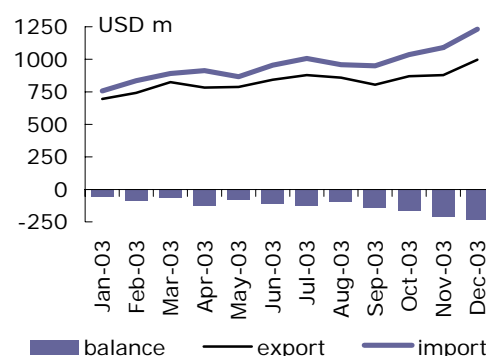
\* Growth rate of volume of contract works;

\*\* Growth rate of retail trade turnover;

\*\*\* GDP growth rate.

Source: Ministry of Statistics and Analysis.

Merchandise Trade



Source: Ministry of Statistics and Analysis.

Merchandise Trade Structure and Dynamics

	2002	2003	Change*
	USD m		
<b>Export of goods:</b>			
Capital	1149.2	1286.5	11.9
Intermediate	4859.3	6209.3	27.8
incl. energy resources	1450.0	2066.4	42.5
Consumption	1933.6	2398.1	24.0
<b>Import of goods:</b>			
Capital	969.8	1245.5	28.4
Intermediate	6446.0	8228.7	27.7
incl. energy resources	2302.8	2996.4	30.1
Consumption	1560.9	1870.1	19.8
<b>Merchandise trade balance:</b>			
Capital	179.4	41.0	-77.1
Intermediate	-1586.7	-2019.4	-27.3
incl. energy resources	-852.8	-930.0	-9.1
Consumption	372.7	528.0	41.7

\* Growth rate, % yoy.

Source: Ministry of Statistics and Analysis.

to 9.3% for the profits tax and from 5.3% to 5.8% for the excise taxes. In January the budget arrears of enterprises went up 26.4%. As of February 1, they amounted to BYR 316.1 bn. The VAT arrears, excise tax arrears and turnover tax arrears were the highest. State enterprises remain the largest debtors of the state (98% of all debt). Thus, improvements to the financial status of enterprises in 2003 were achieved at the expense of a deterioration of the status of the public finances.

The government is planning to set up a "Stabilization Fund" within the central and local administrations in order to insure salary growth for employees who are paid out of state funds. The salary is estimated to reach USD 175 by the end of 2004. Most of the fund's revenues are intended to derive from donations and support by sponsors to state agencies and their structures, and from the revenues of so-called subbotniks (allegedly performing voluntary work, which the government strongly "urges" people to do on certain days). The creation of this fund will lead to a redistribution of financial resources from the real sector of the economy to the state. This will have a negative impact on the structure of the labor supply.

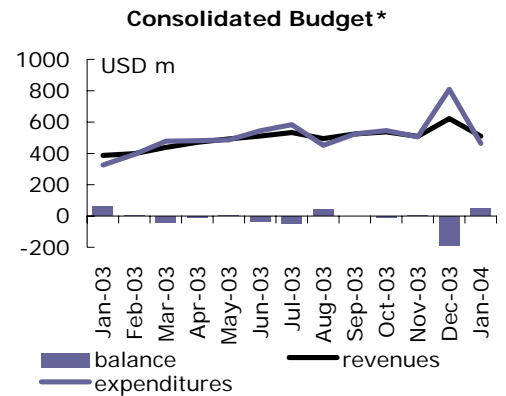
**Monetary Policy: Time ruble deposits of the households increased substantially in January**

In January, the NBB reduced the money supply. The ruble money base was reduced by BYR 67.2 bn. The main component of this money supply reduction was a decrease in net domestic assets. This resulted in decreasing credits to the economy by the commercial banks in January by 1.2% mom. The cash in circulation was reduced by 10.3% mom in January, while the ruble money supply was decreased by 4%. The structure of the ruble money improved significantly. Demand for deposits in Belarusian rubles was still high due to the stability of the Belarusian ruble relative to other currencies, primarily to the US dollar, and due to an increase of the real interest rate for Belarusian ruble deposits. In January time ruble deposits of the households grew by 9.1% mom, while the most liquid elements of the monetary aggregates (cash and transferable deposits) were reduced. At the same time, in spite of a weak currency demand by households, hard currency deposits increased by 2.9% mom primarily because deposits by legal entities increased. As a result, the share of hard currency in the broad money supply went up by BYR 76.8 bn, while total broad money was reduced by BYR 61 bn. This resulted in a further dollarization of the economy.

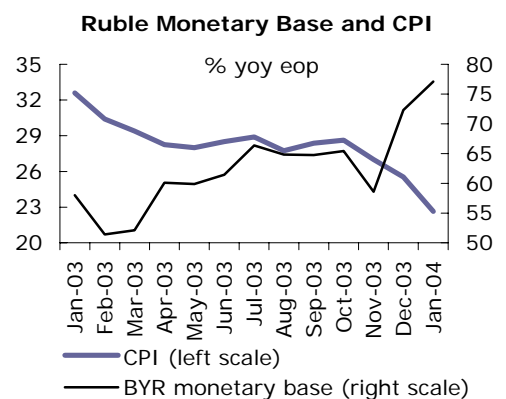
In February the Belarusian ruble appreciated by 0.31% and by 0.23% vis-à-vis the Russian ruble and the US dollar respectively. By the end of the month the exchange rates were 75.43 BYR/RUB and 2151 BYR/USD. Consumer prices grew by 1.9% in January.

**Banking Sector: In 2004 the banks are required to provide BYR 1.5 trn of long-term investment loans**

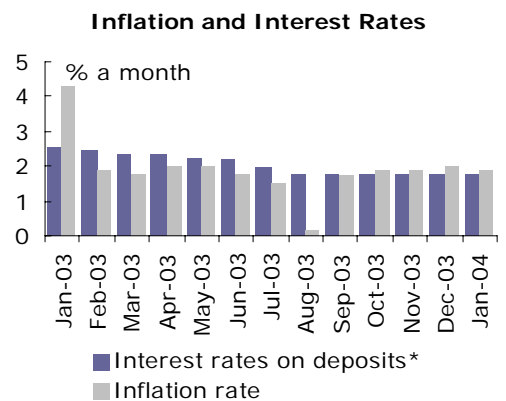
Administrative interference with the activities of banks is likely to continue in 2004. As in 2003, the banks will be forced to credit the real sector and reduce credit interest rates. The Council of Ministers passed a resolution that "recommends" that the banks give BYR 1.5 trn of long-term investment loans to the real sector. About 90% of these loans are to be issued by the authorized banks. In 2003 the majority of these loans were given to state enterprises. The main beneficiaries of these loans are likely to be industrial and agricultural enterprises, many of which are loss making. Taking administrative measures to increase crediting lowers bank liquidity. It has a negative impact on the credit portfolios of the banks and leads to an inefficient distribution of credit resources.



\* Without Social Security Fund. Sources: Ministry of Statistics and Analysis, own calculations.



Sources: NBB, own calculations.



\* Interest rates on new time households deposits in BYR. Sources: NBB, own calculations.

Economic Trends		Q1 02	Q2 02	Q3 02	Q4 02	Q1 03	Q2 03	Q3 03	Q4 03	Nov 03	Dec 03	Jan 04
GDP growth	% yoy	3.9	5.7	4.6	5.5	5.6	4.7	7.2	8.8	--	--	8.2
GDP growth	% yoy cum.	3.9	4.9	4.8	5.0	5.6	5.1	6.0	6.8	6.5	6.8	8.2
Industrial production	% yoy cum.	2.3	4.0	3.9	4.5	7.0	6.3	6.5	6.8	6.9	6.8	11.3
Agricultural production	% yoy cum.	1.8	3.2	2.8	0.7	1.2	-1.5	3.8	6.8	6.2	6.8	4.5
CPI	% yoy eop	46	44	42	35	29	29	28	25	29	25	23
PPI	% yoy eop	39	38	44	42	43	42	36	29	39	29	30
Merchandise export (USD)	% yoy	-7.0	8.4	10.2	24.1	39.2	20.0	22.2	25.3	23.0	26.9	--
Merchandise import (USD)	% yoy	-0.2	2.9	12.9	19.4	39.0	29.8	21.4	21.5	25.7	27.2	--
Merchandise trade balance (NBB data)	USD m cum.	-127	-179	-441	-914	-164	-403	-700	-1189.6	-953	-1189.6	--
Current account	USD m cum.	44	120	-50	-378	-27	-100	-292	-536	-386	-536	--
Current account	% GDP	1.5	2.2	-4.2	-8.7	-0.8	-1.9	-3.8	-3.0	-3.4	-3.0	--
International reserves	USD bn eop	275	257	251	457	463	526	459	474	473	474	494
Monetary Base	% yoy eop	88	58	55	40	52	61	65	72	59	72	77
Lending rate*	% p.a. aop	71	67	55	51	47	41	33	31	30	30	30
Exchange rate (official)	USD aop	1652	1753	1837	1893	1960	2031	2082	2135	2136	2150	2155
Exchange rate (official)	EUR aop	1448	1613	1808	1891	2105	2311	2342	2541	2502	2638	2716

\* 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		1997	1998	1999	2000	2001	2002	2003
Nominal GDP*	BYR trn	0.367	0.702	3.026	9.134	17.173	26.613	35.930
Nominal GDP	USD bn	11.0	8.4	5.7	8.9	12.5	14.8	17.6
GDP growth	% yoy	11.4	8.4	3.4	5.8	4.7	5.0	6.8
Industrial production	% yoy	18.8	12.4	10.3	7.8	5.9	4.5	6.8
Agricultural production	% yoy	-4.9	-0.7	-8.3	9.3	1.8	0.7	6.8
CPI	% yoy aop	64	73	294	169	61	43	29
CPI	% yoy eop	63	182	251	108	46	35	25
PPI	% yoy aop	88	72	355	186	72	41	38
PPI	% yoy eop	90	197	245	166	41	42	29
Exports (gs, USD)	% yoy	17.0	-9.6	-9.7	19.6	8.2	9.0	26.9
Imports (gs, USD)	% yoy	19.5	-6.6	-18.0	21.5	7.1	9.4	27.2
Current account	USD m	-859	-1017	-194	-323	-445	-352	-536
Current account	% GDP	-6.8	-10.9	-3.1	-3.6	-3.7	-2.5	-3.0
FDI (net)	USD m	350	201	443	119	108	434	93
International reserves	USD m	394	339	305	357	347	457	474
Fiscal balance**	% GDP	-5.8	-5.0	-2.9	-0.6	-1.3	-0.6	-1.3
Internal public debt	% GDP eop	4.3	4.9	5.7	4.5	4.5	4.6	6.0
External debt (total)	% GDP eop	20	51	42	24	20	20	--
Monetary base	% yoy eop	96	102	204	52	225	32	50
Exchange rate (official)*	USD aop	34	151	572	1035	1394	1784	2052
Exchange rate (official)*	USD eop	42	430	925	1213	1580	1920	2156
Spread***	% aop	31.1	224.0	128.2	44.4	0.8	0.0	0.0
Spread***	% eop	35.5	301.9	189.1	2.8	0.2	0.0	0.0
Exchange rate (official)*	EUR aop	--	--	270	651	1239	1690	2325
Exchange rate (official)*	EUR eop	--	--	323	1097	1392	1989	2695

\* 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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