

Resumption of economic growth, but inflationary pressure on the rise!

Executive summary

GDP: A high growth of about 10.2% yoy may be achieved in 2010, in case of provision of financial sources for capital investments in the second half of the year. We consider that banks' loans and foreign investments are to be the main sources for this. Active credit support of the economy by banks is based on NBB's active liquidity provision. However, restriction of monetary stimulus in 2011 is going to result in a rapid weakening of the real GDP growth rate. For 2011 we expect a growth rate of 5.7% yoy.

Monetary environment: Monetary stimulus provided by the NBB is to result in a temporary high GDP growth rate, but severe inflationary pressure will be the other side of the coin. We expect that inflation will begin accelerating starting from the second half of the current year. In 2010 as a whole we expect annual average inflation of 12.0% yoy. According to our forecasts an inflation hike will take place next year: We expect annual average inflation of about 20% for 2011.

Public finances: The pressure on public finances is growing in 2010 and 2011 due to deteriorating conditions of oil refinery in Belarus and the remaining need for public support to the real sector in the post-crisis years. The general government deficit will amount to 3.0% of GDP in 2010, while decreasing a bit to 1.8% in 2011 to reduce inflationary pressures in the economy.

Balance of payments: In 2010 the current account balance will show a deficit of USD 7.3 bn (14.0% of GDP) due to the increases in oil and gas prices by Russia. In 2011 the deficit will widen to USD 8.5 bn but the GDP ratio will improve by 0.2 percentage points and reach 13.8% of GDP. The start of the privatisation process and improved access to global financial markets will bring about higher capital inflows in 2010 and 2011. We expect that financial account balance will have a USD 7.5 bn surplus in 2010 and a USD 8.7 bn surplus in 2011.

Key forecast figures

	2007	2008	2009	2010E	2011F
Real GDP, % yoy	8.7	10.3	0.2	10.2	5.7
General government balance, % of GDP*	-0.5	0.1	-1.8	-3.0	-1.8
Current account balance, % of GDP	-3.0	-5.3	-13.1	-14.0	-13.8
CPI, % yoy, aop	8.4	14.8	13.0	12.0	20.3
Gross external debt, % of GDP, eop	27.6	24.9	45.1	55.0	57.0

* According to new classification.

Source: National Statistical Committee, NBB, Ministry of Finance, GET forecasts and estimates.

Forecast calculations were completed in July 2010. Next revision is scheduled for November 2010.

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MACROECONOMY

Domestic demand will drive GDP growth

In the first quarter of 2010, GDP growth of 4.0% yoy was provided from the demand side by two components: net exports and household consumption. Their contribution was 3.2 and 2.9 percentage points of GDP, while the contribution of other aggregate demand components was negative. Despite negative net exports shrinking by 20.8% yoy and thus having provided a positive contribution to GDP growth, this tendency is unlikely to gain momentum. First, this decrease was recorded versus the base of the 1st quarter of 2009, when the trade balance was close to its bottom. Second, low imports of crude oil due to political tensions affected the trade balance severely. Third, the government is still trying to stimulate domestic demand, which leads to a higher demand for imports. We assume that this policy trend is maintained and even strengthened in the second half of 2010. As a result, domestic demand will fuel growth in 2010, while a relatively modest improvement (in comparison to other countries with high trade deficits) of net exports may take place, depending on the changing elasticity of imports on domestic demand.

In the structure of domestic demand we expect changes to occur during the second half of the year. Capital investment is likely to become a main driver of growth due to increasing banks' investment loans and attraction of foreign investment. We estimate the annual growth rate of capital investment in 2010 at 15.6% yoy. However, it should be emphasized that the provision of financial sources for such an amount of capital investment is a key objective for the government in order to lead the economy in the desired direction.

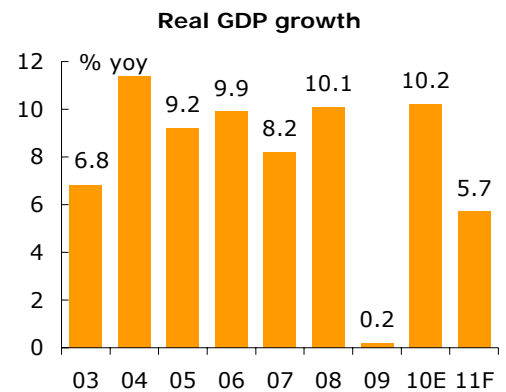
Taking into account the estimated growth in real wages by 12.8% yoy, we derive a growth in household consumption of 4.0% yoy. The recovery of export markets is going to result in 20.0% yoy growth of exports of goods and services. At the same time, if there will be no structural breaks in the elasticity of imports, affecting domestic demand, imports of goods and services will grow by 12.0% yoy. If so, (negative) net exports will improve by 18.5% yoy. Further, we expect inventories to decrease considerable in 2010, if the government refrains from setting artificial targets on output in main industries. This is a result of the recovery of the exports markets, reducing stocks of finished products accumulated in 2009. Moreover, the growth of energy prices will induce enterprises to limit their productive stocks.

Thus, according to our projections, the real GDP growth rate in 2010 will be 10.2% yoy. Strong monetary stimulus provided by monetary authorities (in order to achieve the planned growth rates) is considered to be the key factor of domestic demand stimulation and corresponding high growth rates in 2010. For 2011, we expect the effect of the monetary and fiscal stimulus on the economy to weaken, resulting in deceleration of growth in domestic demand. Furthermore, we see few opportunities for export growth in 2011. At the same time, the growth of demand for imports will be maintained. This implies that in 2011 the GDP growth rate will slow down to 5.7% yoy.

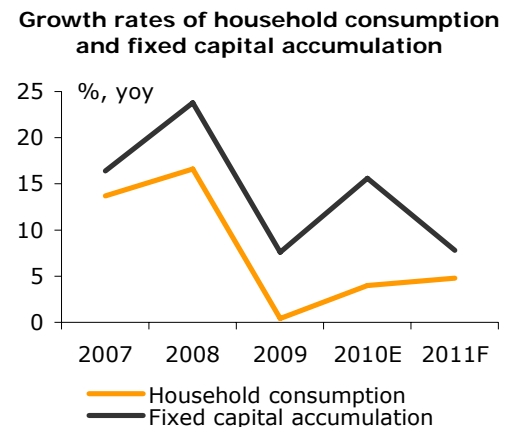
MONETARY ENVIRONMENT

Inflation risks are materialising

Our forecasts in the monetary sphere are based on the assumption that monetary authorities will use foreign borrowings as a balancing tool, in order to maintain and even slight increase



Source: National Statistical Committee, GET forecasts and estimates 2010–2011.



Source: National Statistical Committee, GET forecasts and estimates 2010–2011.

gross international reserves. This issue is crucial for cash money demand and households' and legal entities' choice between national and foreign currency deposits. The assumption of a level of international reserves that is at least stable allows us to suppose the absence of exogenous shocks in money demand in the projected period. Further, while the risk exposure by banks is certainly high, we suppose that a further increase of the money multiplier will be limited. This means that the money supply in the economy (M3) will fully depend on the base money supply by the NBB.

We consider that the NBB will maintain its provision of monetary stimulus in 2010, in order to provide finance for investment growth. Taking into account a growth of net foreign assets by monetary authorities by 6.0% in 2010, we assume a growth of claims on banks of about 30%. It should be emphasized that refinancing of banks by the NBB may be increased, in case of adverse economic environment and the necessity of additional stimulus in order to support the growth of GDP. Finally, we expect a growth rate of base money of 52.0% yoy. At the same time we expect a growth of the banks' claims on the economy of about 40% yoy.

Inflation: Active credit support of the economy directed at stimulating domestic demand will lead to acceleration of inflation in 2010 and its hike in 2011. We believe the inflation risks to be one of most threatening to the Belarusian economy and estimate the average annual inflation in 2010 at the level of about 12%, while in 2011 we forecast its acceleration up to 20%.

Exchange rate: At least for 2010, we suppose that NBB will succeed in maintaining the Belarusian ruble within the declared band of 10% with respect to the currency basket. However, due to the pressure at the domestic currency market we suppose that the national currency will reach the upper bound of this corridor, i.e. the value of the currency basket will reach about BYR 1,133. In this case, the value of the Belarusian ruble versus main international currencies will fully depend on international trends in exchange rates. According to our projections the EUR/USD exchange rate will be 1.3 by the end of 2010, while the Russian currency basket will be at the level of RUB 34 by the end of 2010. In this case, the value of the Belarusian ruble versus the US dollar will be about 3,150, versus Euro 4,095, and versus Russian ruble 105.2 by the end of 2010. Handling the exchange rates within the targeted value of the currency basket will require the NBB and the government to ensure the financing of a huge current account deficit, which otherwise may put considerable pressure on international reserves. If the government succeeds in attracting new borrowings we expect the exchange rate versus US dollar of about USD 3,300 by the end of 2011. However, if the access to foreign borrowings will not allow financing fully the current account deficit, depreciation pressures will rise. Furthermore, if the inflation risks materialise, this will be one more reason to broaden the exchange rate band in order to avoid real effective appreciation.

PUBLIC FINANCES

Growing fiscal pressure

The general government budget is expected to show a deficit of 3.0% of GDP in 2010 (compared to the 1.8% in 2009 according to new budget classification), while the deficit initially planned by the Ministry of Finance was only 1.5% of GDP. The additional pressure on the fiscal sector is the result of the deteriorated conditions for the oil refineries in Belarus. The general government revenues are expected at 32.2% of GDP,

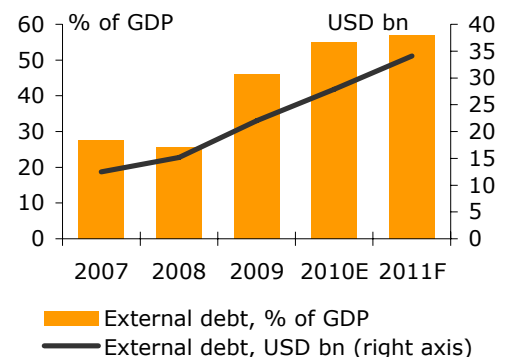
Contributions to GDP Growth

	2009	2010E	2011F
GDP	0.2	10.2	5.7
Households consumption	0.2	2.3	2.6
Gross fixed capital formation	2.9	6.4	3.3
Net exports	1.5	2.5	-2.2
Other components+ statistical discrepancy	-4.2	-1.0	2.0

Note. Contribution to growth – in percentage points of GDP.

Source: 2009 - National Statistical Committee. GET forecasts and estimates 2010–2011.

Gross external debt



Source: NBB, GET forecasts and estimates 2010–2011.

Fiscal indicators, % of GDP

	2009	2010E	2011F
General government revenues	34.1	32.2	31.5
General government expenditures	35.9	35.2	33.3
General government balance	-1.8	-3.0	-1.8

Source: Ministry of Finance, GET forecasts and estimates 2010–2011.

which is 1.9% of GDP less than in 2009. The reduction is explained by the fall in budget revenues from external economic activity, as export duties on petroleum products have been abolished since February 2010. The tax liberalisation reforms are not going to influence the budget revenues to a great extent. The abolishment of agricultural levy and local tax on retail will cut revenues by 1.5% of GDP. However, this fall is compensated by the increased VAT rate (by 1.0% of GDP) and improved economic environment, resulting in a growth of profit tax revenues (by 0.5% of GDP).

The general government expenditures are forecast at 35.2% of GDP; that is by 0.7% of GDP less than in 2009. First of all, the capital expenditures and net lending are expected to be reduced in total by 1% of GDP as the scale of the post-crisis stimuli package will decrease. Some reduction of expenditures should come at the expense of the subsidies to oil refineries, which have been abolished together with the export duties. However, the total sum of subsidies and transfers will not be reduced as the government obviously intends to support the real sector ahead of the forthcoming election, stimulating economic growth above 10% of GDP. The same political reason is behind the slightly growing expenditures on wages and social protection measured in % of GDP.

The deficit of 3.0% of GDP or BYR 4.8 trn can be easily financed both by privatisation receipts and external borrowings, for example in the form of Eurobonds. The government plans to issue up to USD 1 bn worth of Eurobonds in 2010. The main risk within the fiscal sector is a political one, related to the presidential elections and possible populist economic policies. However, the level of public expenditures estimated in this report should be sufficient to reach the political targets. For 2011 we predict reduction of the deficit to the level of 1.8% of GDP.

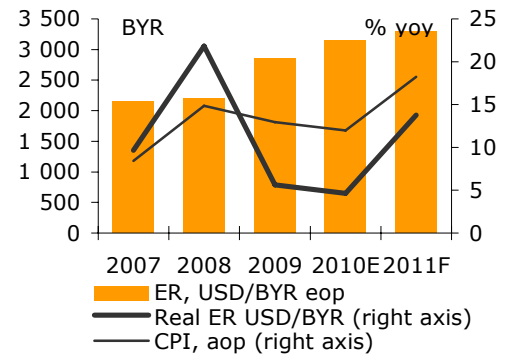
BALANCE OF PAYMENTS

Current account: Current account balance will deteriorate in 2010

In the first quarter of 2010 the trade deficit in goods and services narrowed in comparison to 2009 and the current account deficit contracted to USD 1,127 m. We expect a current account deficit of USD 7.3 bn in 2010 (14.0% of GDP). In 2011 the deficit will widen to USD 8.5 bn but the GDP ratio will improve by 0.2 percentage points and reach 13.8% of GDP. During the first four months of 2010, merchandise export growth was substantially higher than import growth (29.5% yoy and 13.2% in dollar terms, respectively) due to not only some buoyancy in the markets of the main trading partners but also owing to the statistical base effect. For the rest of the year, exports are projected to decelerate and imports to increase. According to our forecast in 2010 merchandise export increase will exceed import growth (24.9% yoy and 22.6% yoy, respectively). Export growth was stronger largely due to recovery in demand for machines and equipment (including products for the automotive industry) in the Russian market, and for potash fertilisers and ferrous metals in non-CIS markets. Increase of imports will be triggered by Russia’s oil and gas price hike, as well as expanding imports of inputs for exports production. We expect that in 2010 the merchandise trade deficit will expand compared with 2009 and account for USD 8 bn.

In 2011, merchandise exports and imports will grow by 17.8% and 18.6% in dollar terms, respectively due to a recovery in domestic demand and of external markets. The merchandise trade deficit will amount to USD 9.1 bn in 2011.

Exchange rates and Prices



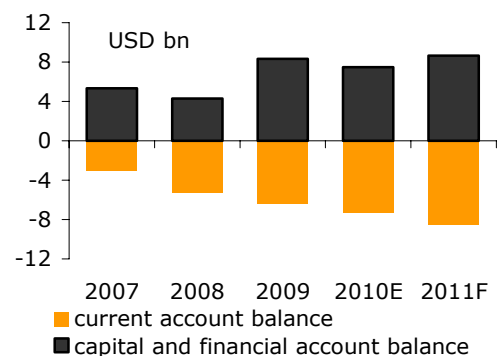
Note. ER – Exchange rate. Source: NBB, GET forecasts and estimates 2010–2011.

Merchandise trade



Source: National Statistical Committee, GET forecasts and estimates 2010–2011.

Balance of payments



Source: NBB, GET forecasts and estimates 2010–2011.

In 2010 and 2011, merchandise trade deficits will be partly compensated by a surplus of USD 1.6 bn and 1.9 bn respectively in trade in services. In 2010 the increase in gas and oil transit fees coupled with higher demand for transportation as well as computer and information services will boost services exports (30.3% yoy in dollar terms). Imports of services will expand at a slower pace (28.0% yoy). The main contributors for this growth will be freight transport services of road transport, construction and travel services, followed by a rise of imports of goods and a revival of economic activity. Our forecast of the growth in service exports and imports in 2011 is 19.8% yoy and 18.0% yoy, respectively. The export growth will be due to a gas transit and transportation services increase partly caused by joining the Customs Union with Russia and Kazakhstan, while import growth is supported by higher demand for transportation and construction services related to the 2014 IIHF Ice Hockey World Championship in Minsk.

We expect that net inflow of current transfers will slightly increase to USD 295 m in 2010 and to USD 340 m in 2011 due and to an increase of technical assistance inflows (European Commission and EBRD programmes). According to the forecast, the negative income balance will expand in 2010 and in 2011 mainly owing to growth of the outflow of dividends on foreign direct investments.

Capital and financial accounts: Financial account balance will significantly improve in 2010

We expect that the start of the privatisation process and improved access to global financial markets will bring about higher capital inflows in 2010 and 2011. In 2010 net FDI inflow will be USD 2.4 bn. The FDI will be attributed to M&A deals in industry, and energy, banking and services sectors. Increase of portfolio investments in 2010-2011 will be caused by placement of Eurobonds (USD 2 bn). Net inflow of other investments is expected at USD 4 bn due to loans. Our forecast of the financial account balance for 2010 is USD 7.5 bn.

In 2011, we expect a robust increase of FDI inflow (USD 5.6 bn) following the sale of the state share of Belaruskali Potash Company. Net portfolio inflow will be at the same level as in 2010 (at USD 1 bn). As a result, the net outflow of other investments will contract to USD 2.1. We expect that financial account will be in surplus at USD 8.7 bn in 2011.

Tables

		2007	2008	2009	2010E	2011F
Table 1. GDP						
Nominal GDP	BYR bn	97,165	129,791	136,790	159,617	198,808
	USD bn	45.3	60.8	49.0	52.3	61.7
Real GDP	% yoy	8.7	10.3	0.2	10.2	5.7
Household consumption	% yoy	13.7	16.6	0.4	4.0	4.8
Public consumption	% yoy	-0.5	0.3	-1.4	-1.1	-5.0
Fixed capital accumulation	% yoy	16.4	23.8	7.6	15.6	7.8
Exports	% yoy	5.7	1.5	-11.3	20.0	-2.0
Imports	% yoy	7.2	14.4	-11.0	12.0	1.4

Table 2. Fiscal Indicators

General government revenues	BYR bn	36,627.3	50,947.7	46,626.7	51,380.0	62,231.5
	% of GDP	37.7	39.3	34.1	32.2	31.5
EPT revenues	BYR bn	3,837.1	5,993.3	4,607.7	6,175.3	8,297.5
	% of GDP	3.9	4.6	3.4	3.9	4.2
VAT revenues	BYR bn	8,669.6	11,399.2	12,083.1	15,697.3	19,360.9
	% of GDP	8.9	8.8	8.8	9.8	9.6
PIT revenues	BYR bn	3,081.1	4,182.9	4,305.3	5,024.3	6,124.4
	% of GDP	3.2	3.2	3.1	3.1	3.1
General government expenditures	BYR bn	37,142.0	50,815.5	49,086.7	56,140.0	65,787.6
	% of GDP	38.2	39.2	35.9	35.2	33.3
Current consolidated fiscal expenditures	% of GDP	--	--	24.2	24.4	23.0
Capital consolidated fiscal expenditures	% of GDP	--	--	8.2	7.7	7.4
General government balance	% of GDP	-0.5	0.1	-1.8	-3.0	-1.8

Table 3. Balance of Payments

Current account balance	USD bn	-3.0	-5.3	-6.4	-7.3	-8.5
	% GDP	-6.6	-8.7	-13.1	-14.0	-13.8
Export of goods	USD bn	24.4	32.8	21.3	26.6	31.3
Import of goods	USD bn	28.4	39	28.3	34.7	41.1
Balance of services	USD bn	1.2	1.6	1.4	1.6	1.9
Capital and Financial Accounts	USD bn	5.3	4.3	8.3	7.5	8.7
Foreign direct investments (FDI)	USD bn	1.8	2.2	1.8	2.4	5.6
Portfolio investments	USD bn	0.0	0.0	0.0	1.0	1.0

Table 4. Base money and Inflation

Base money	BYR bn	24,506	30,961	38,107	57,855	70,567
	%, yoy	40.0	26.3	23.1	51.8	22.0
CPI	%, yoy aop	8.4	14.8	12.9	11.9	20.3
Exchange rate	USD, eop	2,150	2,200	2,859	3,150	3,300

Sources: National Statistical Committee, Ministry of Finance, NBB, GET forecasts and estimates 2010–2011.

Notes:

E	estimate	F	forecast
aop	average of period	NBB	National Bank of Belarus
bn	billion	p.a.	per annum
eop	end of period	yoy	year-on-year
EPT	enterprise profit tax	ytd	year-to-date
VAT	value added tax	PIT	personal income tax
tcm	thousand cubic metres		

Assumptions of the forecast

- The major markets for Belarusian exports will gradually recover in 2010 and 2011.
- World prices for crude oil (oil basket) will be USD 66 per barrel on average in 2010 and USD 68 per barrel on average in 2011.
- The prices of imported gas from Russia will be USD 171.5 per tcm (yearly average) in 2010 and USD 234 per tcm in 2011.
- Social assistance and state support programs will be somewhat streamlined in 2011.
- The Government will pursue policies aiming at increasing the average wage to USD 400 by the end of 2010.
- Tax rates will not change in 2011.
- The Government will receive loans from China in 2010 and 2011.
- The Government will issue Eurobonds in 2010 and 2011.
- Belaruskali will be privatised in 2011.

About the German Economic Team Belarus

The joint project of the German Economic Team Belarus and the IPM Research Center was launched in May 2003 with support of the German Federal Ministry of Economy under the TRANSFORM program. The main objective of the project is to support the Belarusian government in the field of economic policy. To achieve this, the team of experts regularly prepares analytical papers on different topical issues and presents recommendations to officials from the Ministry of Economy, the Ministry of Finance, the National Bank, the Ministry of Foreign Affairs and other institutions involved in the process of formation and implementation of economic policy.

Activities

- Regular analysis of the economy of Belarus;
- Monitoring of main sectors of the economy;
- Promotion of professional dialogue between Belarusian and German experts on important issues for the economic development of Belarus.

Team

German Economic Team in Belarus

- Prof. Dr. Stephan von Cramon-Taubadel, agriculture and real sector, co-leader
- Dr. Ricardo Giucci, macroeconomy and financial sector, co-leader
- Robert Kirchner, macroeconomy and financial sector, consultant
- Dr. Georg Zachmann, energy economics and infrastructure, consultant

IPM Research Center

- Dr. Igor Pelipas, monetary economics and applied econometrics, Director of the IPM Research Center
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- Dzmitry Kruk, M.A. in Economics, banking sector and macroeconomic modelling
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- Gleb Shymanovich, M.A. in Economics, transport sector and public finance

Analytical materials

Current research products and publications of the project group are available via the Internet:

<http://research.by/get> and www.get-belarus.de

Belarusian Monthly Economic Review (BMER)

A monthly bulletin has been published since October 2002. It provides readers with recent news on politics and economics, covering such sectors of the economy as the real sector, structural trends, the external sector, public finance, monetary policy and the banking sector.

Policy Papers

Analytical materials on specific economic issues providing policy recommendations for the government and other organisations involved in the process of formulating and implementing economic policy.

Belarus Infrastructure Monitoring

Monitoring of the current situation and the perspectives for the development of the energy, telecommunications and transport sectors in Belarus. The following sectors are monitored in detail: electricity, gas, communication and communication services, railways and roads.