

Top Priority: Macroeconomic Stabilisation

Executive summary

GDP: Due to high growth in the first half of 2011, the rate of annual growth is expected to be rather high – 5.3% yoy. However, this figure is associated with a considerable fall in major domestic demand components in the second half of 2011, which is the consequence of their artificial growth at the end of 2010/beginning of 2011. Despite automatic adjustments having taken place in 2011, the issue of macroeconomic stabilisation is still of prior concern for 2012. Due to expected significant reduction of the price for imported gas and new loans from Russian banks that may be used for fixed capital investments, we forecast a small growth of 1.6% in 2012.

Monetary environment: Inflationary and devaluation expectations, along with signs of stress in the banking system are the key challenge for the monetary sphere now and for the entire 2012. For 2011, the rate of inflation is projected at about 125% at the end of the year (55.1% annual average). Temptation of smoothing output dynamics or strengthen the solvency of the banking system through monetary injections may accelerate the inflation-devaluation spiral further in 2012. However, a more conservative monetary and fiscal policy (which is what we expect) will result in a gradual moderation of inflation to about 25% at the end of 2012. These dynamics imply that the annual average inflation will stay very high at 72.7%.

Public finances: The need to combat inflation and to stabilise the exchange rate will be the key challenges for the fiscal stance of the country. It forces a reduction of capital expenditures and public purchases in 2011 and 2012. Expenditures on current transfers are expected to increase as a response to the decline in the population's welfare and increased risk of poverty in 2012. These trends will result in a balanced primary general government budget in 2012, after estimated budget surplus of 0.5% in 2010.

Balance of payments: In 2011 the current account deficit will be around USD 6.5 bn, or 14.4% of GDP, but it will narrow in comparison to the previous year due to growth of trade in petroleum products and potash fertilizers, and the devaluation of the Belarusian ruble. In 2012 the deficit will drastically fall to USD 2.5, or 4.7% of GDP. We forecast that FDI inflows will be quite moderate in 2011 but will increase in 2012 due to the sale of state shares in enterprises. We expect capital and financial account balance will be in surplus at USD 6.9 bn in 2011 and at USD 7.7 bn in 2012.

Key forecast figures

	2008	2009	2010	2011E	2012F
Real GDP, % yoy	10.3	0.2	7.6	5.3	1.6
General government primary balance, % of GDP*	1.4	-0.7	-2.6	0.5	0.0
Current account balance, % of GDP	-8.6	-13.0	-15.5	-14.4	-4.7
CPI, % yoy(aop)	14.8	13.0	7.8	55.1	72.7
Gross external debt, % of GDP	24.9	45.1	52.2	75.5	74.3

* Since 2010 Social Security Fund is not included.

Sources: National Statistical Committee, NBB, Minfin, GET forecast and estimates.

Forecast calculations were completed in November 2011. Next revision is scheduled for April 2012.

IPM Research Center
50Б Zakharova St., Minsk 220088, Belarus
Tel. (+375 17) 210 0105
E-mail: research@research.by
Internet: <http://www.research.by/>

German Economic Team Belarus
c/o Berlin Economics GmbH
Schillerstr. 59, D-10627 Berlin
Tel. +49 30 / 20 61 34 64 0
E-mail: info@get-belarus.de
Internet <http://get-belarus.de/>

MACROECONOMY

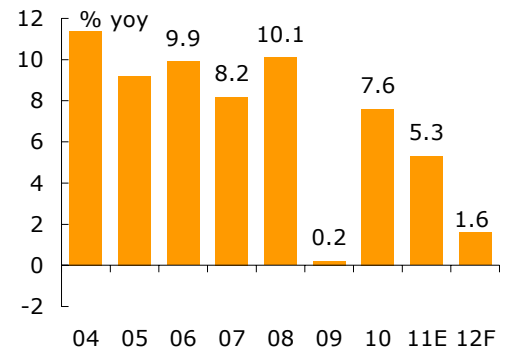
Adjusting to a new environment: Decrease in domestic demand and improvement of net exports

The year 2011 has become a period of automatic macroeconomic adjustment. Since the authorities avoided recognition of the accumulated distortions and imbalances in the economy, they missed the chance of managing this adjustment in an orderly fashion. Huge depreciation of the national currency generated rapid price growth, which nevertheless made possible some depreciation in real terms. During the second part of the year, price and exchange rate shocks have been transmitted to the real economy. On the one hand, foreign exchange shortages and the depreciation led to a gradual improvement in external trade, mainly through lowering demand for consumer imports and improvements in capital goods exports. Therefore, in 2011, net exports are going to become an engine of growth, though at the beginning of the year the latter was artificially triggered due to high domestic demand. According to our projections, the contribution of net exports to GDP growth in 2011 (5.3% yoy) is going to be 4.7 percentage points in GDP growth. On the other hand, rapid price growth hits the components of domestic demand and especially household consumption. Despite significant growth at the beginning of the year, on the annual basis it is expected to be roughly at the same level as in 2010. However, its stagnation over the year assumes a huge decrease at the third and fourth quarter. As for capital investments, due to more impressive growth at the beginning of the year they are going to perform growth of about 4.1% yoy at an annual basis. This growth was overwhelmed by a certain real inertia, i.e. during the first months of the currency crisis, financing of state investment programs (mainly through directed loans) was maintained almost unchanged, while its reduction required rather long administrative procedures. Overall, 2011 might have become the year, when economic forces cleaned up the main distortions, thus giving a chance for more responsible economic policy in the future.

Preconditions for 2012 are pretty much the same as in the 3rd and 4th quarter of 2011: main domestic demand components are going to gravitate to their natural long-run equilibrium levels, while net exports are going to improve (at least due to the statistical effect of high deficit in the 1st half of 2011, which will alter annual dynamics). However, reduction of the gas price will become a significant positive shock for the economy. If the economy will not be affected by negative strong external shocks or new interference by the government, it is going to grow at about 1.6% yoy. Among the components of the domestic demand, household consumption is going to display the worst downward dynamics – we project its contribution to GDP growth of -1.3 percentage points– because of expected higher saving ratio. Furthermore, new external borrowings from Russian banks may prevent decline in capital investments because of the lack of financial sources. Net exports are going to provide a positive contribution to GDP growth (of 2.1 percentage points) under this scenario.

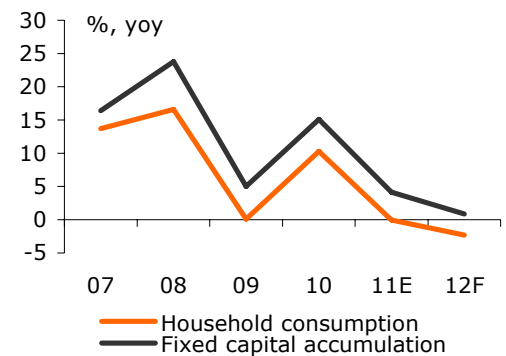
The scenario of eliminating main macroeconomic distortions might be violated by the desire of the government to increase GDP growth rates, which might exploit additional tools in stimulating economic activity. Given huge inflation and depreciation expectations, such policy may result in accelerating the depreciation-inflation spiral. If that is the case, rapid growth of prices might hurt the economy considerably. Thus, further expansionary policy may result in a deep recession combined with the disorganisation of the financial system.

Real GDP growth



Source: National Statistical Committee, GET forecasts 2011–2012.

Household consumption and fixed capital accumulation



Source: National Statistical Committee, GET forecasts and estimates 2011–2012.

Contributions to GDP Growth

	2010	2011E	2012F
GDP	7.6	5.3	1.6
Households consumption	5.9	0.0	-1.3
Gross fixed capital formation	6.0	1.8	0.4
Net exports	-4.0	4.7	2.1
Other components+ statistical discrepancy	-0.4	-1.2	0.4

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

Source: 2010 - National Statistical Committee. GET forecasts and estimates 2011–2012.

MONETARY ENVIRONMENT

Inflation is the priority challenge

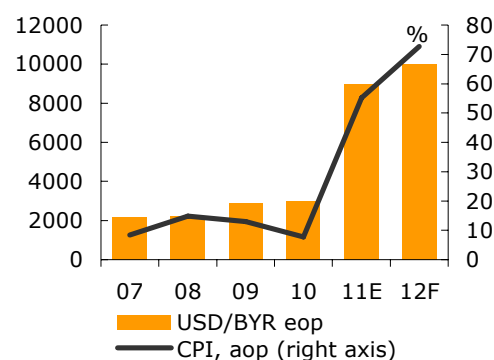
The period of uncontrolled depreciation and inflation in 2011 caused huge inflation and devaluation expectations. Further, due to a significant pass-through from nominal exchange rate to prices in Belarus, the national economy seems not having reached a real exchange rate level that is needed to provide external stability. The advantages obtained from nominal devaluation are quickly eliminated by the growth of prices, which, in turn, requires additional devaluation to restore external stability. However, the room for spurring inflation and devaluation in order to smooth adjustment in the real economy seems to be over. Further expansionary policy may result in a complete loss of nominal anchor by economic agents, which will change their market behavior radically. This may generate further reduction of the demand for the national currency both for transaction and savings purposes, which will contribute to further inflation and devaluation. Furthermore, uncertainty on the expected nominal parameters may strengthen the mechanisms of adverse selection and moral hazard in the economy. Thus, there will be much more pre-conditions for transmitting currency shocks to other segments of the financial market, first of all to the banking sector. Deterioration in the quality of banks' assets may either lead to direct negative impact on the real economy through a credit crunch, or additional liquidity injections to the banking system by monetary authorities. Both paths are seemed to be dangerous in a sense that they will lead to uncontrolled inflation and accommodative monetary policy. So the scenario of an inflationary deep recession will be inevitable in this case.

This means that the adjustment strategy based on the exchange rate should be supplemented by restricting domestic demand and carrying out tight monetary policy in order to reduce the pass-through from nominal exchange rate to prices. The government seems to be aware of these risks and we expect that restrictive policy will take place according to the government's plan. We use this assumption in our forecast, but it should be mentioned that ignoring these requirements might result in transfiguring the behavior of economic agents and more rapid price growth and devaluation.

Inflation: Our projection for 2011 is 55.1% of annual average inflation, which corresponds to an expected inflation rate of 125.0% at end-2011. However, it should be admitted that a huge share of prices is still controlled by the government (energy tariffs, utility tariffs, etc.), which may shift a part of the expected growth in prices from the current year to the next one. If we assume that main tariffs controlled by the government will be adjusted during next year and taking into account the base effect, then annual average inflation in 2012 will be even higher and amount to a massive 72.7%. However, this figure disguises the fact that inflation will follow during the course of the year a gradually declining trend and amount to 25.0% at year-end.

Exchange rate: With respect to the nominal exchange rate, we expect the regime of managed float. Thus we set nominal exchange rate exogenously, but taking into consideration two tasks for it: (i) preventing a further inflation-devaluation spiral, which may force the economy to depression, and (ii) providing a level of the current account deficit that can be financed according to our assumptions on capital inflows. Finally, we expect the level of 9000 USD/BYR as of the end of 2011, and 10000 USD/BYR as of the end of 2012. This assumes modest depreciation of the national currency in 2012.

Exchange rate and prices



Source: NBB, GET forecasts and estimates 2011-2012.

PUBLIC FINANCES

Fiscal policy tightening

The forecast for public finance sector development in 2011–2012 is based on the same assumptions as the previous one from April 2011. However, the previous forecast underestimated the scale of the currency crisis and consequently inflation and devaluation effect on the economy, which resulted in significant changes in general government budget parameters. Currently general government primary budget is forecast to generate a surplus of 0.5% of GDP in 2011 and to be balanced in 2012. It is a result of inflation tax on the one hand, and necessity for more strict fiscal policy on the other hand.

General government expenditures in 2011 are estimated to equal 26.9% of GDP, which is 5.6 percentage points less than in 2010 (payments on public debt principals not included). Reduction of expenditures is explained by economic policy measures, targeted at elimination of distortions that caused import growth in the beginning of 2011 followed by inflation and devaluation. The cut is forecast in both current and capital expenditures. Reduction of public support to construction sector and public investment program reconsideration will lead to the general government capital expenditures fall to 4.8% of GDP (compared to 8.4% on 2010). Current expenditures are expected to suffer 2.2% of GDP reduction. It will occur at the expense of such lines as wages (reduction by 0.8% of GDP), and public purchases (by 1.1% of GDP). The stance of general government expenditures in 2012 is forecast to be largely the same with no growth of capital expenditures and wage increases in real terms. The only exception is growing public transfers, as a measure of social support to groups of the population that are highly exposed to poverty risk such as elderly, children, unemployed. Besides, slight decrease of public purchases is expected, as a mechanism of restraining inflation. It will boil down to expenditures of 26.0% of GDP.

General government revenues are forecast to suffer a less sharp decline. In 2011 they are estimated to equal 27.4% of GDP compared to 29.9% in 2010. Reduction is expected at the expense of tax revenues. Most of the fall comes from VAT (by 1.0% of GDP) due to new rules of VAT payment and import contraction, as well as taxes on foreign trade (by 0.8% of GDP), which are expected to fall in the second half of 2011 on the back of new prohibitive import tariffs on vehicles. Some increase can be observed in profit tax revenues due to the first half of the year booming sales. In 2012 revenues are forecast at the same level, except taxes on foreign trade that will fall further (1.0% of GDP) due to the tariffs on vehicles. As a result general government revenues are forecast at 26.0% of GDP in 2012.

BALANCE OF PAYMENTS

Current account: Spectacular Improvement

We expect the deficit of trade in goods and services will narrow in 2011 to USD 2.6 bn (5.8 % GDP) helping to shrink the negative current account balance to USD 6.5 bn in 2011 (14.4% of GDP). In 2012 it will continue its downward trend to USD 2.5 bn, and will likely hover around 4.7% of GDP.

For 2011 we expect higher growth rates of exports than imports (69.9% and 38.2% respectively). Export growth will be attributed to the growth of trade in petroleum products with non-CIS countries caused by new terms of Russian oil supply to Belarus, an impressive recovery of world potash fertiliser consumption, and some rise in ferrous metals demand. The

Fiscal indicators, % of GDP

	2010	2011E	2012F
Consolidated revenues	29.9	27.4	26.0
Consolidated expenditures	32.5	26.9	26.0
Deficit	-2.6	0.5	0.0

Source: Ministry of Finance, GET forecasts and estimates 2011–2012.

Merchandise trade



Source: National Statistical Committee, GET forecasts and estimates 2011–2012.

devaluation of Belarusian ruble will have a positive impact on the growth of Belarusian exports to Russia. Coupled with the continuing buoyancy of the Russian market it will encourage sales of Belarusians machines and, as well as food products. An increase of imports in 2011 will be triggered by Russia’s gas price hike, a rise of total annual volume of Russian and Venezuelan crude oil supplied to Belarus, as well as expanding imports of inputs for exports production. At the same time, consumer goods’ imports are forecast to decrease due to reduction of domestic demand caused by devaluation of Belarusian ruble and high inflation. We expect that in 2011 merchandise trade deficit will be 2 times lower than in 2010 and account for USD 4.6 bn. In 2012, merchandise trade deficit will go down further and is expected to be at around USD 287.3 m.

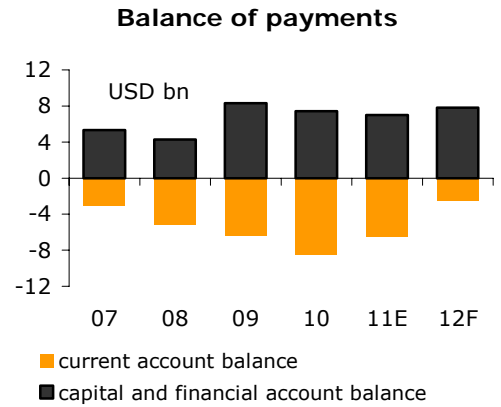
In 2011, the merchandise trade deficits will be partly compensated and in 2012 fully compensated by a surplus of USD 1.9 bn and 2 bn, respectively, in trade in services. In 2011 exports of services will go up, owing to increase in oil and gas transit fees. Growth of imports of services will be influenced by possible shrinking of consumer goods imports that will result in growth slowdown of freight transport services of road transport, as well as contraction of travel services imports due to reduction of households’ spending capacity.

We expect that the current transfers balance will be negative in 2011 and 2012 due to the fact that Belarus has to transfer export duties on oil refinery products to Russian budget. The transfer of these duties will significantly exceed the inflow of customs duties accrued according to the agreement between Russian, Belarus and Kazakhstan on distribution of import customs duties within the Customs Union. According to the forecast, the negative income balance will expand in 2011 and 2012 mainly owing to a growing deficit of investment incomes stemming from an increase of amount of interest payable under general government (including interests payment on the IMF loan) and non-financial sector obligations (including payment on the loans of banking and nonfinancial sectors, and income payments on FDI).

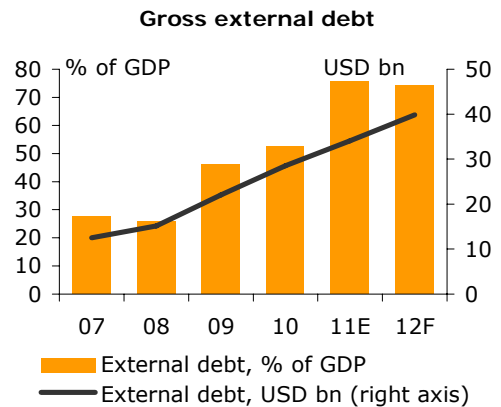
Capital and financial account: Balance will narrow in 2011 and slightly increase in 2012

We expect that in 2011 net FDI inflow will be USD 1.6 bn. The FDI inflow will be attributed to M&A deals in industry, banking and service sectors (including possible payment of a first tranche for the remaining shares of Beltransgaz). Portfolio investments in 2011 will be USD 800 m and caused mainly by the placement of Eurobonds at the beginning of the year. Net inflow of other investment is expected at USD 4.5 bn due to the attraction of loans (including loan from Russia and Anti-crisis Fund of the EvrAzES USD 1.24 bn, as well as USD 300 m loan from Azerbaijan to Belaruskali guaranteed by the government of Belarus).

In 2012, we expect that the sale of the state shares of Beltransgaz and mobile operator MTS, as well as state-owned enterprise shares will result in an increase in FDI inflows (USD 2.3 bn) in comparison with the previous years. We do not forecast the inflow of portfolio investments in 2012. We expect that the capital and financial account surplus will increase by 11.3% yoy in 2012.



Source: NBB, GET forecasts and estimates 2011-2012.



Source: NBB, GET forecasts and estimates 2011-2012.

Annex. Tables

		2008	2009	2010	2011E	2012F
Table 1. GDP						
Nominal GDP	BYR bn	129 791	137 442	162 964	282 387	509 015
	USD bn	60.8	49.2	54.7	45.2	53.6
Real GDP	% yoy	10.2	0.2	7.6	5.3	1.6
Household consumption	% yoy	16.6	0.1	10.3	0.0	-2.3
Public consumption	% yoy	0.3	-0.1	0.9	-11.7	2.4
Fixed capital accumulation	% yoy	23.8	5.0	15.1	4.1	0.9
Exports	% yoy	1.5	-11.3	2.8	35.9	-2.7
Imports	% yoy	14.4	-11.7	8.2	20.2	-5.2

Table 2. Fiscal Indicators*

General government revenues	BYR bn	65 663	62 808	48 773	77 240	132 513
	% of GDP	50.6	45.7	29.9	27.4	26.0
EPT revenues	BYR bn	5 993	4 608	5 580	11 047	20 922
	% of GDP	4.6	3.4	3.4	3.9	4.1
VAT revenues	BYR bn	11 399	12 083	16 226	25 306	45 615
	% of GDP	8.8	8.8	10.0	9.0	9.0
PIT revenues	BYR bn	4 183	4 305	5 381	8 900	15 733
	% of GDP	3.2	3.1	3.3	3.2	3.1
General government primary expenditures	BYR bn	63 811	63 766	52 981	75 840	132 571
	% of GDP	49.2	46.4	32.5	26.9	26.0
Current consolidated fiscal expenditures	% of GDP	37.1	34.6	24.2	22.0	22.0
Capital consolidated fiscal expenditures	% of GDP	10.0	8.1	8.4	4.8	4.0
General government primary balance	% of GDP	1.4	-0.7	-2.6	0.5	0.0

Table 3. Balance of Payments and External Debt

Current account balance	USD bn	-5.2	-6.4	-8.5	-6.5	-2.5
	% GDP	-8.6	-13.0	-15.5	-14.4	-4.7
Export of goods	USD bn	32.8	21.4	25.3	43.1	43.3
Import of goods	USD bn	39.0	28.3	34.5	47.7	43.6
Balance of services	USD bn	1.6	1.4	1.7	1.9	2.0
Capital and Financial Accounts	USD bn	4.3	8.3	7.4	7.0	7.8
Foreign direct investments (FDI)	USD bn	2.2	1.8	1.3	1.6	2.3
Portfolio investments	USD bn	0.0	0.0	1.2	0.8	0.0
Gross external debt	% of GDP	24.9	45.1	52.2	75.5	74.3

Table 4. Money, Inflation and Exchange Rate

Base money	%, yoy eop	11.7	-11.5	49.5	75.1	2.6
CPI	%, yoy aop	14.8	12.9	7.7	55.1	72.7
Exchange rate, USD/BYR	eop	2 200	2 859	3 000	9 000	10 000

*- Since 2010 Social Security Fund is not included into consolidated budget.

Sources: National Statistical Committee, Ministry of Finance, NBB, forecast 2011-2012 – GET.

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
EPT	enterprise profit tax	PIT	personal income tax
VAT	value added tax		

Annex. Assumptions of the forecast

- World prices for crude oil (oil basket) will be USD 100 per barrel on average in 2011 and USD 90 per barrel on average in 2012.
- Belarus will get 19 mt and 21.5 mt of crude oil from Russia in 2011 and 2012 respectively on a duty-free basis. Moreover, in 2011 and 2012 3.5 mt of Venezuelan and Azerbaijan oil will be imported, which will correspondently contribute to exports of oil products.
- The prices of imported gas from Russia will be USD 263 per tcm (yearly average) in 2011 and USD 150 per tcm in 2012.
- In 2012 the government will receive USD 1.5 bn of privatization revenues, and USD 2.6 bn of new foreign borrowings.
- The government restricts both current consumption and capital expenditures.

About the German Economic Team Belarus (GET Belarus)

The main purpose of GET Belarus is to conduct a dialogue on economic policy issues with the government, civil society, and international organizations. Experts of German Economic Team have experience in policy advice in several transition economies, including Ukraine, Russia, and Kazakhstan. In Belarus the IPM Research Center and the German Economic Team provide information and analytical support to the Council of Ministers, the National Bank, the Ministry of Foreign Affairs, the Ministry of Economy and other institutions involved in the process of formation and implementation of economic policy.

About the IPM Research Center

The IPM Research Center was established in 1999 within the mutual project of the Institute for Privatization and Management (Minsk, Belarus) and CASE - Center for Social and Economic Research Foundation (Warsaw, Poland). It is a member of the CASE research network, William Davidson Institute NGO Alliance, and Economic Policy Institutes Network (project of the UNDP's Regional Bureau for Europe and the CIS). The IPM Research Center actively cooperates with the German Economic Team Belarus (GET Belarus). Within this cooperation the IPM Research Center provides independent policy advice on economic issues to the different official agencies, namely to the Council of Ministers, National Bank, Ministry of Economy, Ministry of Finance and other organizations involved in the process of formation and implementation of economic policy.

The Mission of the IPM Research Center is to enhance national competitiveness through elaboration of the research-based economic policy recommendation and the promotion of professional dialogue on the urgent issues related to economic performance.

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.

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.