INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 06/101
FOR IMMEDIATE RELEASE
August 25, 2006

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2006 Article IV Consultation with the Republic of Belarus

On August 4, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Belarus.[1]

Background

Belarus's centralized, state-dominated economy has performed well over the past few years. The government's centrally administered, socially oriented policies have facilitated rapid real income growth, near-full employment, and a reduction in poverty to the lowest level in the CIS.

GDP growth averaged 8.2 percent in 2002–05. Favorable energy import prices have supported high growth, particularly in 2005. A widening gap between world prices for Belarus's energy-intensive exports and prices of energy imports from Russia have provided a large and increasing amount of trading gains. These have been distributed throughout the economy—including through transfers and subsidies to state-owned enterprises, high budgetary investment, as well as economy-wide mandated wage increases, and recommended lending—supporting domestic demand. Belarus also benefited from strong partner country growth, which, together with terms-of-trade improvements, helped swing the current account into a surplus of 1.6 percent of GDP in 2005. Moreover, economic stabilization and rising incomes have strengthened consumer confidence, further contributing to increasing domestic demand. The economy's positive momentum has carried forward into 2006.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Ample production capacity has allowed twelve-month inflation to decline steadily over the past few years, to 6.9 percent in May 2006. However, rising unit labor costs, tighter capacity utilization in many sectors, a high and increasing ratio of Producer Price Index to Consumer Price Index inflation, and estimates of underlying inflation suggest a build-up in inflation pressures. Low inflation also reflects, in part, administrative controls over price formation.

Macroeconomic data may not tell the whole story. While the quality of statistics is generally good, extensive state controls over the economy—notably on prices— complicate the assessment of economic developments and of the impact of policy actions.

After a broad balance in 2004, the 2005 budget recorded a deficit of 0.7 percent of GDP, despite a 2¼ percent of GDP revenue windfall from the booming energy sector and from the switch to the destination principle for the value added tax in trade with Russia from the beginning of 2005. The 2005 deficit excluding oil-related revenues of around 6 percent of GDP suggests continued fiscal sensitivity to energy pricing. The 2006 budget recorded a—largely seasonal—3.1 percent of GDP surplus through May against a budgeted full-year deficit of 1½ percent of GDP.

While officially targeting the Russian ruble, the National Bank of the Republic of Belarus (NBRB) has maintained a stable exchange rate vis-à-vis the U.S. dollar, which facilitated further gradual dedollarization and rapid increases in international reserves in 2005. The refinance rate was reduced by 600 basis points in 2005 and by a further 50 in June 2006. Reserve requirements were also lowered twice in 2005 and 2006, by one percentage point each time. These developments triggered an increase in liquidity that the NBRB sterilized to a large extent, in a context of further remonetization.

State banks continued to lend at the government's behest for designated purposes mostly at controlled and subsidized interest rates. The resulting decline in these banks' liquidity and profitability necessitated budgetary recapitalizations of 1.1 percent of GDP. NBRB credit to the nonfinancial nongovernment sector has also increased, reaching ½ percent of GDP in April 2006. As a result, credit to the economy has continued growing, while the share of nonperforming loans fell to below 2 percent at end-2005. Banks have improved provisioning, covering about 90 percent of the requirement as of May 2006.

Progress with structural reforms has been limited. The remaining significant role of the state in the economy and administrative restrictions on the movement of labor and in other areas hamper market flexibility and private investment.

Executive Board Assessment

Executive Directors noted that Belarus has enjoyed several years of relatively strong macroeconomic performance. In particular, growth has been rapid since 2003, and inflation has declined further, remaining in single digits since the second half of 2005. This economic performance has reflected broadly the authorities' pursuit of prudent fiscal and monetary policies, as well as strong growth in partner countries, although price controls have also contributed to declining inflation.

Most Directors observed that the strong growth of recent years owed much to energy imports from Russia at markedly below-market prices, while prices for Belarus's energy-intensive exports had grown considerably. The resulting large and increasing terms-of-trade gains had been redistributed, financing rapid wage increases, budgetary support to enterprises, and large-scale investment projects that had underpinned the policy of strong government interference in the economy.

Directors emphasized that the outlook seems much less favorable than recent trends. They noted that current World Economic Outlook energy price projections suggest that terms-of-trade gains are set to halt from 2007. Indeed, the possibility of significantly less subsidized energy imports could impart a considerable downside risk to the outlook. Directors also pointed to Belarus's declining market share in the CIS, the large and growing non-oil current account deficit, the low level of international reserves, and the diminishing output gap. In light of these considerations, most Directors called for a fundamental change of course in policies, notably in the structural and fiscal areas. In particular, they stressed the importance of an up-front fiscal tightening, calling for early liberalization of prices and wages, followed by broader structural reforms.

Directors welcomed the authorities' intentions to implement fiscal and structural measures by 2010, especially to curb budgetary transfers and subsidies, reduce the tax burden, strengthen the financial system, moderate real wage increases, and attract foreign investors. However, Directors noted that a more rapid withdrawal of state intervention, including early liberalization of prices and wages, would help to underpin strong noninflationary growth in the medium term. They stressed that structural reform measures should be implemented without delay, while the economy is still in a position of strength. In this context, several Directors noted the importance of improving the institutional framework and governance, and several Directors pointed to the need to build social consensus for the reforms. Directors welcomed the authorities' strong track record regarding the implementation of technical assistance from the Fund, and endorsed the provision of further technical assistance in support of the reform agenda.

In particular, Directors argued for rapidly phasing out directed bank lending, bringing all remaining state support to enterprises on-budget, ensuring that budgetary and public sector wages grow in line with productivity, and curtailing the golden share rule to apply to only a handful of preannounced strategic enterprises. Directors cautioned against using privatization proceeds or increased foreign borrowing to sustain an unaltered state-dominated economic structure—a strategy that would only postpone the inevitable macroeconomic adjustment, while increasing its costs.

Directors argued that fiscal tightening, starting already in 2006, is necessary to cope with the impact on the budget of a stabilization of the terms of trade. The case for this policy stance is reinforced by the risk that the terms of trade might weaken, heightening the possibility that a relatively loose fiscal policy would prompt inflationary pressures and undermine competitiveness. Fiscal savings—primarily in the form of expenditure retrenchment—are also required to finance the cost of structural reforms and offset the planned reduction in Belarus's high tax burden. With a view to safeguarding the effective social safety net and productivity growth, these cuts should focus on phasing out subsidies and transfers to loss-making enterprises, and discontinuing bank recapitalizations associated with directed lending. Directors also noted the need to reduce budget rigidities by phasing out earmarking.

Turning to monetary policy, Directors believed the NBRB should clarify that controlling inflation is its primary objective. In this regard, most Directors stressed that the NBRB should accept more flexibility in the exchange rate in the event of inconsistency between the inflation and exchange rate targets. They also found that further policy interest rate cuts should be contingent on clear signs of lasting declines in inflationary pressures. Directors noted that to enhance the credibility of the NBRB's commitment to the inflation objective, its operational independence would need to be strengthened, the number of its quantitative targets pruned, its direct lending to the economy discontinued, and interest rate caps eliminated.

Directors commended the NBRB on the progress in strengthening the supervisory framework. However, they emphasized that, against the backdrop of continued rapid credit growth, the NBRB needs to remain vigilant in enforcing all prudential requirements. Directors welcomed the recent steps toward attracting strategic foreign investors to the banking system, while stressing the importance of transparent and competitive privatization procedures. It was also suggested that anti-money laundering legislation should be improved to meet international best practices.

Directors noted that the quality of the statistical system and the timeliness of data are broadly adequate.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The Staff Report of the 2006 Article IV Consultation with the Republic of Belarus is also available.

Republic of Belarus: Selected Economic Indicators

	2002	2003	2004	2005 Preliminary
	(Annual change in percent, unless otherwise indicated)			
Real economy				
GDP (nominal in billions of rubels)	26,138	36,565	49,992	63,679
Real GDP	5.0	7.0	11.4	9.3
Industrial production	4.5	7.1	15.9	10.4
CPI (average)	42.6	28.1	18.1	10.3
Real average monthly wage (1996=100)	231.9	238.7	279.0	338.6
Average monthly wage (in U.S. dollars)	107.3	123.3	162.0	217.4
Money and credit				
Reserve money	32.0	69.7	41.9	73.7
Rubel broad money	59.6	71.0	58.1	59.6
Banking system net domestic credit	53.7	68.9	39.1	34.8
Refinance rate (percent per annum, end-of-period)	38.0	28.0	17.0	11.0
	(In percent of GDP)			
General government finances 1/				
Revenue	44.5	45.9	46.0	48.4
Expenditure (cash)	46.6	47.7	46.0	49.1
Expenditure (commitment)	46.7	46.9	45.6	49.0
Balance (cash)	-2.1	-1.7	0.0	-0.7
Balance (commitment)	-2.2	-1.0	0.4	-0.6
	(In millions of U.S. dollars unless otherwise indicated)			
Balance of payments and external debt				
Current account balance	-311	-424	-1,206	469
As percent of GDP	-2.1	-2.4	-5.2	1.6
Gross international reserves	477.8	499.0	770.2	1,297
In months of future imports of goods and services	0.6	0.3	0.5	0.8
Medium- and long-term debt (as percent of GDP)	9.9	8.1	4.8	4.2
Short-term debt (as percent of GDP)	17.0	15.6	16.7	13.8
	(Rubels per U.S. dollar)			
Exchange rates				
Average	1,784	2,052	2,160	2,154
End-of-period	1,920	2,156	2,170	2,152

Sources: Data provided by the authorities and IMF staff estimates.
1/ Consolidates the state government and Social Protection Fund budgets.