INTERNATIONAL MONETARY FUND

Staff Country Reports

September 2007
IMF Country Report No. 07/310

Republic of Belarus: 2007 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Belarus

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2007 Article IV consultation with the Republic of Belarus, the following documents have been released and are included in this package:

- The staff report for the 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 4, 2007, with the officials of the Republic of Belarus on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 10, 2007. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff supplement of August 22, 2007 updating information on recent developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its August 24, 2007 discussion of the staff report that concluded the Article IV consultation.

- Statement by the Executive Director for the Republic of Belarus.

The document listed below has been or will be separately released.

Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF BELARUS

Staff Report for the 2007 Article IV Consultation

Prepared by Staff Representatives for the 2007 Consultation
with the Republic of Belarus

Approved by Poul M. Thomsen and Martin J. Fetherston

August 10, 2007

Executive Summary

Discussions were held in Minsk during May 23–June 4, 2007. Staff met with Deputy Prime Minister Kobyakov, Minister of Economy Zaichenko, Minister of Finance Korbut, National Bank of the Republic of Belarus (NBRB) Chairman Prokopovich, representatives of the presidential administration, other senior officials, members of parliament, representatives of the business and academic communities, and the press.

Staff team: Mr. Horváth (head), Mr. Mates (Senior Moscow Resident Representative), Ms. Hassine, Ms. Koliadina, Mr. Ross (all EUR), assisted by Resident Representative office staff. Mr. Kiekens (Executive Director for Belarus) joined some meetings.

Background: The economy has expanded rapidly since 2004. However, rising energy import prices from 2007 represent a large permanent income loss, straining Belarus's centralized economy.

Discussions focused on the appropriate policy response:

- Staff assessed the real exchange rate as *overvalued* by some 10 percent. The authorities disagreed and saw no problem with competitiveness. Staff noted that maintaining the exchange rate peg under the authorities' planned policies could entail unsustainably high current account deficits over the medium term.
- The NBRB was confident it can *maintain the peg* and restrain inflation despite rapid credit growth. The authorities viewed adjustment as feasible within the existing policy framework. They have tightened fiscal policy so far this year (while envisaging a full-year deficit), moderated wage growth, partially increased energy prices, strengthened price controls, and secured large-scale foreign financing. They expected public investment and concessional lending to encourage energy savings, as well as export-oriented and import-substituting activities.
- Staff argued that while *reliance on foreign financing* was possible for some time, adjustment was unavoidable since the terms-of-trade change was permanent. Thus, early adjustment through a tighter policy mix commensurate with the economy's real income loss was needed, including a full energy price pass-through, no fiscal stimulus given the accommodating policy mix and the exchange rate peg, and a phase-out of directed lending to contain credit growth. Structural reforms were necessary to reduce unit labor costs.
- Financial sector *discussions focused on risks* stemming from marked credit growth, government operations through the banking system, and banks' foreign liabilities.

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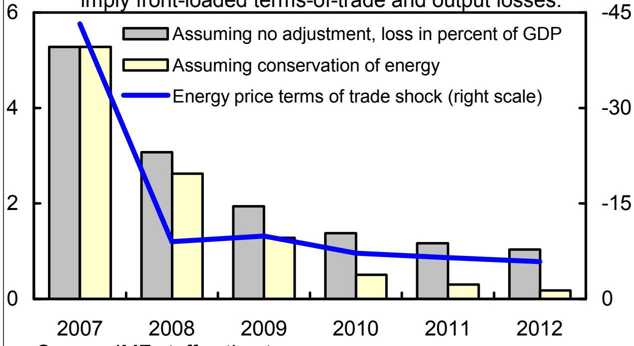
I. Introduction

1. **Benefiting from a favorable energy arrangement with Russia, Belarus's centralized economy grew rapidly over the past few years.** The state redistributed terms-of-trade gains associated with energy trade across the economy, boosting domestic demand, while a de facto peg anchored inflation expectations. As a result, output expanded rapidly. Of CIS states, Belarus received the largest energy subsidy from Russia since 2002.

2. **A new multi-year energy agreement, however, has abruptly reversed these terms-of-trade gains.** Belarus now pays twice as much for Russian gas supplies as in 2006 and the windfall earnings it received from re-exporting cheap Russian oil supplies have diminished. This represents a 45 percent decline in its *energy terms of trade* in 2007, resulting in an estimated loss of 5½ percent of GDP. Higher export prices and lower energy intensity of production could lower the net impact by about 1½ percentage points this year. Energy prices are set to rise in the next few years, but losses will be smaller, particularly if additional declines in energy intensity occur.[1] Nevertheless, cumulative losses through 2012 may reach 10–15 percent of GDP.

Higher energy import prices and WEO price projections imply front-loaded terms-of-trade and output losses.

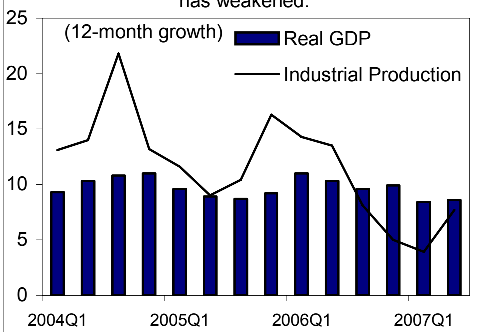


Source: IMF staff estimates.

A. Economic Developments

3. **Economic growth remained strong through the first half of 2007.** Growth accelerated to 9.9 percent in 2006 as rapid real wage gains supported consumption, while state-directed credit boosted investment—up 26 percent in 2006 and 30 percent (y-o-y) in the first quarter of 2007. Fuel exports, a main driver of industrial production, have slowed significantly in the first half of 2007, as production dropped at both refineries owing primarily to import interruptions in January–February (Figure 1). As a result, annual real growth moderated to 8.6 percent in January–June.

Growth has remained strong, but industrial production has weakened.

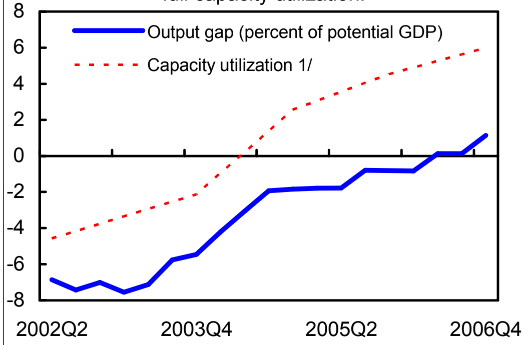


Source: Belarus authorities.

[1] Natural gas import prices will reach Europe's level by 2011; Belarus's share of Russia's oil export tax will rise from 29 to 36 percent by 2009.

4. **However, capacity constraints appear to be emerging.** Supply has responded strongly during the expansion, supported by high investment. Rising output also boosted measured productivity.[2] However, simple output gap analysis and capacity utilization indicators as well as labor market data signal incipient capacity constraints. The PPI-based real exchange rate appreciation—up 55 percent since 2000—and strong import demand also indicate tightening resource constraints.

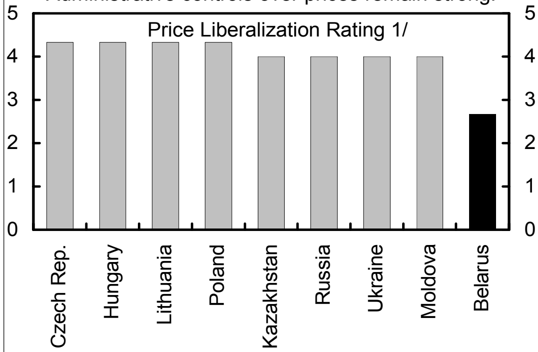
Available indicators point to the economy being close to full capacity utilization.



Sources: Belarus authorities; and IMF Staff Estimates.
1/ Percentage point deviation from long-term average in industry.

5. **Headline inflation declined further in 2006, but use of administrative controls has increased.** Price controls, decelerating money growth and the exchange rate anchor helped to slow consumer price inflation to 6.6 percent by end-2006. With producer prices and import costs still rising rapidly—and the direct and indirect effects of higher energy prices now being felt—underlying cost pressures have increased. While producer prices jumped by 13.5 percent through May, annual CPI inflation rose to 7 percent—limited by additional price caps (Figure 2).

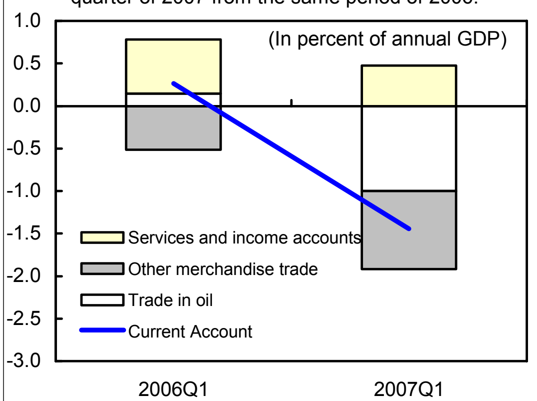
Administrative controls over prices remain strong.



Source: EBRD Transition Report 2006.
1/ A rating of 1 indicates most prices formally controlled by the government; 4.33 indicates complete price liberalization with no price control outside housing, transport, and natural monopolies.

6. **The current account swung into deficit in 2006, with a further marked deterioration in the first quarter of 2007.** Net export volumes fell by 27 percent in 2006 and by 11 percent in the first quarter against the background of declining export market penetration to Russia and rising unit labor costs (Figure 3). Propelled by strong import growth in non-oil products and muted non-oil export growth, the current account went from a surplus of 1.6 percent of GDP in 2005 to a deficit of 4.1 percent in 2006 (Figure 4). This shortfall from a targeted surplus occurred despite favorable terms-of-trade developments last year.

The current account deteriorated sharply in the first quarter of 2007 from the same period of 2006.



Sources: Belarus authorities; and IMF staff estimates.

[2] Despite strong domestic investment, the recorded capital stock has remained low, suggesting high depreciation. With employment flat, implausibly high rates of TFP are implied.

The 2007 first quarter deficit reached 1½ percent of annual GDP compared to a small surplus in Q1 2006 and a 2.3 percent of GDP surplus in Q1 2005. Boosted also by privatization receipts, external borrowing allowed a rebuilding of NBRB foreign exchange reserves to around one month of imports by July.

7. **External borrowing increased, and more was being secured for 2007.** External debt was low at around 19 percent of GDP at end-2006, but is rising rapidly. Loans and asset sales receipts expected in 2007–08 exceed the estimated net impact of the terms-of-trade decline. Besides having applied for a sovereign rating, the government is also contemplating T-bill issues in Russia.

Belarus: Expected New Financing, 2007–08
(Percent of GDP)

	2007	2008
Total new financing	7.2	5.1
FDI total, *of which*	1.9	1.5
Privatization of part of Beltransgaz 1/	1.4	1.2
Reinvested earnings	0.2	0.2
Privatization of banks 1/	0.1	0.0
Gas pipeline Yamal-Western Europe	0.1	0.0
Foreign borrowing, *of which*	5.4	3.6
Loan from the government of Russia	2.3	0.9
Foreign bank credit lines	0.7	0.0
Foreign borrowing by commercial banks	1.5	1.2
Short-term borrowing	0.9	1.4

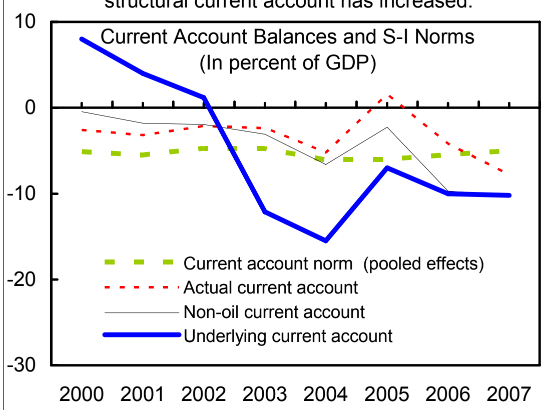
Source: IMF staff estimates.

1/ Funds received by end-June, 2007.

8. **Staff estimates that the rubel is overvalued by about 10 percent.** This estimate is subject to considerable uncertainty.

- The *macrobalance approach* indicates a sizable gap between Belarus's underlying and structural current account. Applying estimates from CGER regressions to Belarus data, staff estimates the *structural deficit* at around 5 percent of GDP—a percentage point above regional norms, but in line with other fast-growing countries. The *underlying* current account has steadily deteriorated—from a surplus to a large deficit—as real appreciation eroded competitiveness while domestic absorption rose.[3] A real exchange rate elasticity of 0.4 for current account changes would imply an overvaluation of about 8 percent (it was in the 7–15 percent since 2004). The lack of correlation between the actual and underlying current accounts, however, suggests that the latter may be imprecisely estimated.

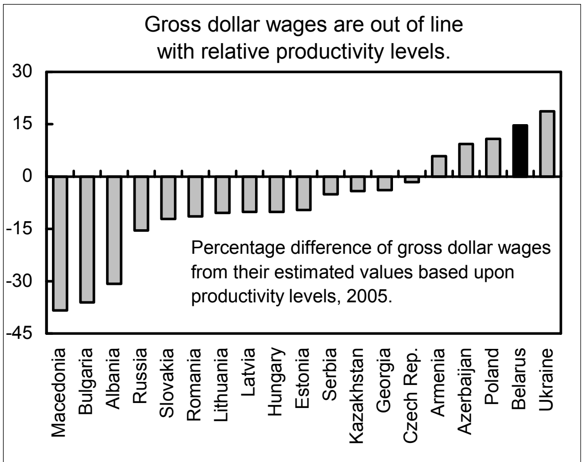
The gap between the underlying and structural current account has increased.



Sources: Belarus authorities; and IMF staff estimates.

[3] The underlying current account filters out the effects of past changes in real exchange rates and relative absorption from the non-oil balance.

- A regression of *U.S. dollar wages* on productivity for Eastern European and CIS countries suggests the rubel may be overvalued by about 15 percent. Non-wage compensation, which can be substantial in the region, was excluded from the analysis.



Sources: Haver; Eurostat; and IMF staff estimates.

- A *vector error-correction model* for the real exchange rate implies an overvaluation below 10 percent. It finds significant long-run coefficients of 0.8 to 0.9 for the terms of trade, net foreign assets, and relative productivity. Several of these variables are likely to decline over the medium term in the absence of policy adjustment, which could increase the overvaluation, although the economy's response to the terms-of-trade deterioration is uncertain at this stage.

B. Policy Developments

9. **The fiscal stance turned contractionary in 2006 and in the first half of 2007.**

- The general government moved from a deficit of 0.6 percent of GDP in 2005 to a surplus of 0.5 percent in 2006 (Figure 5). Indeed, higher cyclical revenues and energy-related gains—a more than doubling of excise rates on oil products, and one-off receipts[4]—also allowed the authorities to cut the sales tax rate from 3.9 to 3.0 percent and abolish the Chernobyl tax and the employment insurance contribution. Moreover, the taxation of financial and nonfinancial enterprises was harmonized. Expenditures were cut by 1 percent of GDP (¾ percent in goods and services).

- During the first five months of 2007, fiscal policy was tighter than budgeted, as expenditure restraint and a new tax-subsidy system raised the surplus to 1.9 percent of annual GDP,[5] against an annual 2007 budget deficit target of 1.5 percent of GDP.

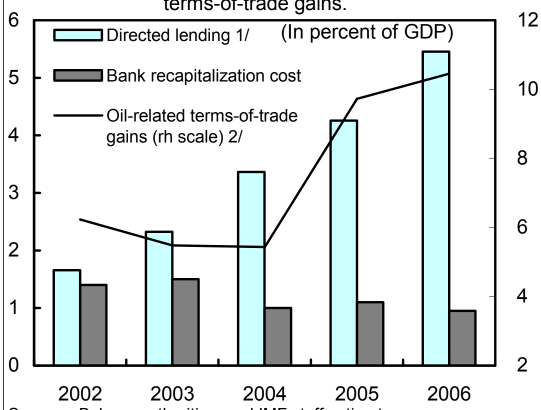
10. **However, government intervention in the economy continued to provide an underlying expansionary impulse.** This included directed concessional lending—of about 5½ percent of GDP in 2006, up from 4¼ percent in 2005—through state owned banks to

[4] Presidential decrees centralized 0.9 percent of GDP from key SOEs income into the budget.

[5] This was 1 percentage point above the average January–May surpluses in 2003–06.

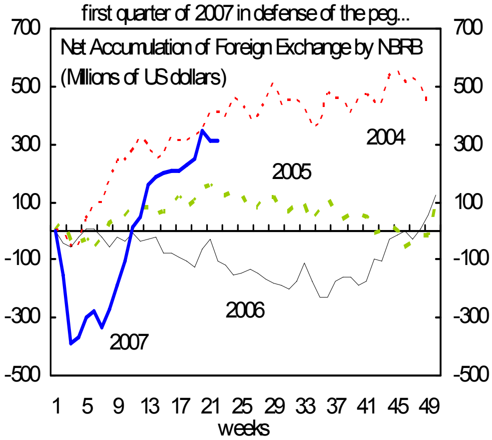
SOEs, and the placement of large government deposits in selected state-owned banks to raise bank liquidity depleted by credit growth. Government-mandated wage increases in excess of productivity at SOEs constituted a third channel, prominent through end-2006. Wage growth has now been scaled back,[6] although real wages and unit labor costs continue to increase. Moreover, real income growth in the first five months of 2007, compared to the same period last year, reached 17.2 percent. Real incomes grew by 17.3 percent in 2006.

Directed lending remained high on the back of rising terms-of-trade gains.

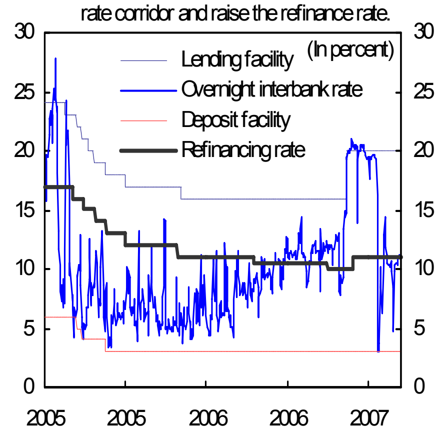


Sources: Belarus authorities; and IMF staff estimates.
1/ Commercial bank directed lending is estimated for 2006.
2/ Calculated as the difference between the import bill that would arise at full world market energy prices and the actual one.

The NBRB's net foreign exchange sales were heavy in the first quarter of 2007 in defense of the peg...



...which forced it to widen its long-standing interest rate corridor and raise the refinance rate.

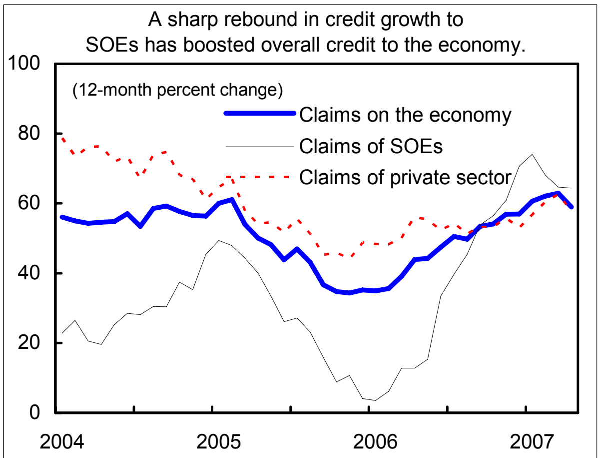


Sources: NBRB; and IMF staff estimates.

11. **The exchange rate peg to the U.S. dollar drove monetary policy, with monetary conditions accommodative.** In 2006, monetary conditions were relaxed as the refinance rate was reduced by 100 basis points and reserve requirements lowered as credit growth was picking up (Figure 6). Pressure on the peg—owing to concerns over new energy prices and the immediate availability of foreign financing—forced the NBRB to raise its policy rates and restrained money growth in early 2007.[7] However, monetary conditions eased from April and the NBRB lowered the refinance rate by 25 basis points in July.

[6] Real wages rose by 10.1 percent in January–June 2007 compared with the same period a year ago, versus 20.1 percent on the basis of the same definition in the first half of 2006. Over the same periods, annualized unit labor costs rose by 1.6 and 10.5 percent, respectively.

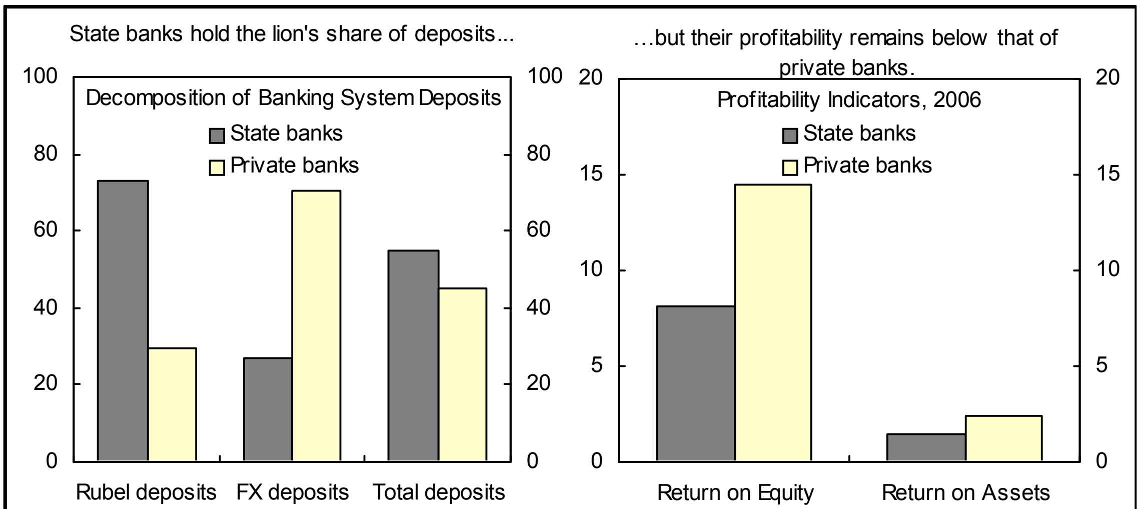
[7] Broad money growth January to May was 4 percent, versus 38 percent over same period last year.



Sources: Belarus authorities; and IMF staff estimates.

12. **Continued rapid credit growth is now partly being financed by increases in banks' foreign liabilities.** Annualized credit growth picked up substantially, exceeding 50 percent in real terms by end-April (Figure 7). Surging credit had been financed by rapid growth in rubel deposits (up by over 40 percent in 2006). However, the rise in interbank interest rates throughout 2006 suggests that liquidity was tightening. Following the market turbulence in early 2007, the switch into dollar deposits has not reversed—and growth in longer-term rubel deposits has been non-existent. Thus banks are now financing the upsurge in credit growth increasingly through rising foreign borrowing and government deposits.

13. **Financial soundness indicators appear adequate, but significant weaknesses remain.** Banking system net domestic assets—at 20 percent of GDP—remain relatively low and largely short term, with over 80 percent controlled by four large state banks. Recurrent recapitalizations of these systemic banks fall short of the long-run costs of directed lending, imperiling their solvency; moreover, their liquidity depends in part on government deposits. While increased bank lending and a change in tax laws have increased banking assets and profitability, state owned banks' profitability remains relatively low. NPLs are also low, but there are liquidity concerns at state-owned banks (Figure 8).



Sources: NBRB; and IMF staff estimates.

14. **The pass-through of higher energy import costs to domestic energy tariffs was partial.** Natural gas prices have risen by up to 89 percent for enterprises, but only 20 percent for households. Electricity and heating tariffs went up by 40 percent for all users. The new tariffs represent an average pass-through of approximately 60 percent of the terms-of-trade shock. This places additional burden on enterprises, possibly requiring higher future subsidies.

15. **Progress in structural reform has been limited.** Belarus lags behind its peers in most structural reform indicators and has attracted a low level of foreign direct investment. Fixed investment, while ample, has been mainly directed to housing construction, agriculture, and state industrial concerns. Low profitability of SOEs and commercial banks as well as high ICOR figures imply relatively low investment productivity.

Belarus: Performance Indicators

	Belarus	CIS average
EBRD enterprise restructuring indicator 1/	1.0	2.0
Investment in percent of GDP 2/	26.5	20.4
Budgetary capital spending (2006)	9.6	4.5
FDI (in percent of GDP) 2/	1.0	6.9
Banking system RoA 2/	1.3	2.9
Banking system RoE 2/	7.2	16.8
Percentage of industrial enterprises with profitability below 5 percent (April 2007)	58.0	…

Sources: EU Commission, EBRD Transition Report.
1/ Range 1-4; industrial market economy standards equal 4.
2/ Average 2002-06.

II. Report on the Discussions

16. **The discussions focused on the outlook and the appropriate policy response to the terms-of-trade shock.** Staff and the authorities agreed that the shift toward world market energy prices was permanent. Views, however, did not converge on the sustainability of current policies, and hence on the need for fundamental adjustment, or the components of the appropriate policy response.

- **The authorities expected a much stronger supply response within existing policy and institutional frameworks than staff.** They considered gradual adjustment with heavy reliance on external financing as appropriate, expecting government-led investment to raise productivity and energy efficiency, thus avoiding capacity constraints going forward. Staff was more skeptical, viewing public investment as less efficient and spare capacity less abundant. Staff also pointed to low enterprise profitability, and viewed the past surge in productivity as largely cyclical in nature. It argued that since sharply higher energy prices made part of the existing capital stock obsolete, absent structural reforms, the supply response would remain limited.

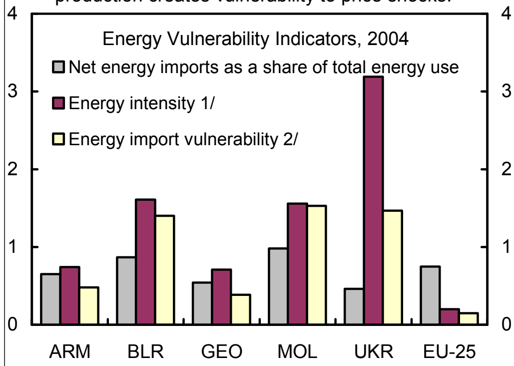
- **The authorities wished to retain the exchange rate as the key nominal anchor.** They considered this feasible given their expectation of a strong supply response and assessment that competitiveness was adequate. In staff's view, the authorities' planned policies were not sufficient to maintain an exchange rate anchor, potentially resulting in unsustainable current account deficits over the medium term. Staff was

skeptical about the authorities' ability to generate an adequate supply response to maintain the peg. The mission argued, therefore, that the authorities would have to rely more than currently envisaged on demand-management policies, which would require tighter monetary, fiscal, and incomes policies.

A. Medium-Term Outlook

17. **Uncertainties regarding the external environment and implementation of national policies provided background to the outlook.** The term-of-trade deterioration will adversely affect growth, inflation, the current account and fiscal balances. However, scope for further increases in energy efficiency and reductions in energy import volumes that would limit external vulnerabilities was less assured. Similarly, the refineries may not receive contracted crude oil volumes during 2007, although this remains possible with additional governmental assistance. Also, it was unclear if recent increases in non-oil export prices could be sustained. A key question was external financing: the terms and conditions of loans were undefined and the ability to attract sustained capital flows, including FDI, uncertain. Finally, the extent to which the authorities plan to follow stated policies as described in their socio-economic plan was equally uncertain.

High net energy imports and intensity in production creates vulnerability to price shocks.



Source: IEA and EU Report OP, No. 30, June 2007.
1/ Total energy supply to GDP, t.o.e. per thousand of U.S. dollars.
2/ Net energy imports times energy intensity.

18. **Staff noted that the negative impact of the terms-of-trade deterioration created macroeconomic tensions under planned policies, and advocated reforms.** If—as *officially planned*[8]—directed lending continues and the budget runs deficits while real wages rise further, pressures on the current account and on reserves will escalate, eventually forcing the authorities off the peg (see Figure 9 and text table for an illustrative scenario denoted "*Officially planned policies*" along these lines). Instead, to support the peg under a *reform* scenario, the authorities should allow a full energy price pass-through, compress real wage growth, restrain second-round inflation effects through tighter fiscal and credit policies, and implement structural reforms to reduce government intervention and liberalize markets. In such a reform scenario, inflation would temporarily rise and growth would decelerate, but the underlying external instability problem would be addressed with a much lower debt buildup. Most importantly, these measures would set the stage for sustainable growth over the medium term. *Staff baseline* projections strike a middle ground that staff considers feasible. They broadly reflect the authorities' objectives and plans, with fiscal policy adjusted—

[8] Policies as promulgated in the authorities' *2006–10 Socio-Economic Plan*.

consistent with the actual fiscal stance through June 2007—and with flat real wages to make the overall policy mix compatible with a financeable current account path.

Belarus: Alternative Scenario Table							
	2006	2007	2008	2009	2010	2011	2012
		Projections					
Staff scenario under officially planned policies 1/							
			(Change in percent)				
Real GDP Growth	9.9	8.5	7.8	2.1	-2.4	-1.8	-1.2
Inflation, average	7.0	12.5	14.9	25.1	23.8	22.8	21.1
Terms of trade	3.8	-17.3	-1.9	-4.6	-1.8	-0.3	-2.5
Real Wage, average	11.4	8.5	7.5	3.5	4.5	3.0	2.9
			(Percent of GDP)				
Fiscal Balance	0.5	-1.5	-3.0	-2.8	-2.4	-2.3	-2.1
Current Account	-4.1	-11.1	-14.6	-3.6	-4.3	-3.8	-3.4
Energy	0.3	-3.4	-5.2	-6.9	-7.6	-7.8	-7.1
Non-energy	-4.4	-7.7	-9.4	3.3	3.3	4.0	3.7
External Debt	18.6	33.7	50.7	61.7	95.7	109.6	121.3
Staff baseline scenario 2/							
			(Change in percent)				
Real GDP Growth	9.9	7.8	6.4	5.7	5.2	4.8	4.4
Inflation, average	7.0	8.1	10.0	10.2	9.4	8.2	7.9
Terms of trade	3.8	-17.3	-1.9	-4.6	-1.8	-0.3	-2.5
Real Wage, average	11.4	0.0	0.0	0.0	0.0	0.0	0.0
			(Percent of GDP)				
Fiscal Balance	0.5	0.5	0.5	0.3	0.1	0.0	0.0
Current Account	-4.1	-7.9	-8.1	-8.0	-7.6	-7.4	-7.0
Energy	0.3	-3.4	-5.2	-6.9	-7.6	-7.8	-7.1
Non-energy	-4.4	-4.5	-2.9	-1.1	0.0	0.4	0.1
External Debt	18.6	25.6	31.4	37.1	41.4	45.5	48.8

Sources: Ministry of Statistics and Analysis; and IMF staff calculations.
1/ Staff scenario that reflects implementation of policies under the authorities' *2006–10 Socio-Economic Plan*. The plan assumes continued high rates of credit growth, directed lending, real wage increases, and import substitution. Under this scenario, staff assumes the rubel will be forced off the peg, and devalued by 25 percent in 2009.
2/ Staff scenario which reflects the outcome of broadly implementing the authorities' plans, but with fiscal policy adjusted in line with the actual fiscal stance in the first half of 2007. With a further assumption of zero growth in real wages, the overall policy mix is compatible with a financeable current account path.

- In the *short term*, higher energy prices, marked credit growth, and seasonal government spending should raise inflation to double digits. Owing to substantial carryover effects and continued high investment spending, growth will remain strong, reaching 7¾ percent in 2007. At the same time, with the nominal peg intact and further energy import price increases, the real exchange rate will likely appreciate, keeping the current account deficit around 8 percent in 2007–08.

- Over the *medium term*, second-round energy price effects, continued loose credit policies and binding capacity constraints would keep inflation around 8–9 percent.

With a continued neutral fiscal stance, wage moderation, and higher inflation, the decline in real incomes should scale back consumption. While state-directed investment spending would support activity, growth should fall over the medium term to around 4½ percent. Given the lack of structural reforms, progress toward improving competitiveness would remain limited. With further terms-of-trade losses and rising debt service costs offset in part by weakening domestic demand, the current account deficit would hover around 8 percent. The doubling of the external debt-to-GDP ratio to almost 50 percent and extensive short-term borrowing highlights growing risks.

19. **The authorities saw staff's baseline forecast as overly pessimistic and were confident their economic targets could be met.** Despite the changed external environment, they considered their targets for 2007 and beyond—growth of 8½ percent, inflation under 8 percent, and current account surpluses—achievable with the policies and institutions underpinning their pro-growth model largely intact. Arguing that there was no competitiveness problem, the authorities considered they could reach a current account surplus through concessional lending to export-oriented and import-substituting activities. In their view, the pause in dedollarization was temporary, the economy's recent performance proved the efficiency of public investments, and Belarus's low debt levels left scope for large-scale foreign financing for many years. Borrowed funds would be invested to reduce energy intensity, mitigating the impact of rising energy prices and improving competitiveness. Finally, offering SOEs in manufacturing, food processing, and communications for sale would generate new innovation-enhancing FDI.

B. Fiscal Policy

20. **Staff argued for avoiding a fiscal stimulus.** Additional terms-of-trade losses expected in coming years and the need to offset the expansionary stance of other policies requires fiscal tightness. The large surplus in January–June helped stabilize currency markets and lower inflationary pressures. Allowing spending to rise during the remainder of the year—in line with the government's budget deficit target of 1.5 percent—would raise liquidity by 3.2 percent of GDP in the second half of 2007. This could be destabilizing given loose credit conditions. Avoiding a fiscal stimulus would require a surplus of ½ percent of GDP, still allowing a deficit of about 1.4 percent of GDP during the second half of the year.

21. **With over 20 percent of revenues linked to the energy sector, the impact of the terms-of-trade deterioration on budgetary performance is likely to be significant.** Revenues would decline by 2.8 percent of GDP, while a discretionary increase in assistance to refineries, automatic stabilizers and a higher goods and services bill adds another 2.5 percentage points of GDP to expenditures, resulting in an overall budgetary deterioration of 5.3 percentage points. This gap is partially offset (2.4 percentage points) by higher export taxes on oil products as required under the agreement with Russia. Given an already high fiscal burden, staff advocated covering the remaining 2.9 percentage points by cuts in

subsidies to enterprises and banks, together with improved targeting of social spending and reduced investment and net lending.

The 2007 Fiscal Impact of Higher Energy Prices and Possible Compensatory Measures
(Change from 2006 in percentage points of GDP)

	Impact	Measures	
Revenue	**-2.8**	**2.4**	
Tax revenue	**-1.9**	**2.4**	
Profit tax	-0.7		Weaker tax base
Personal income tax	-0.3		Weaker tax base
VAT	-0.2		New exemptions (e.g., oil refineries, construction)
Excises	-0.7		Lower excise rates on oil products
Custom duties (including export tax)		2.4	Higher export tax on oil products
Non-tax revenues	**-0.9**		High dividend payments from SOEs impossible in 2007
Expenditure	**2.5**	**-2.9**	
Goods and services	0.3	-0.3	Higher budgetary energy costs offset by lower spending
Subsidies	1.9	-2.0	
to oil refineries	1.6		Subsidies to offset Russian export tax on crude oil
to housing utilities	0.3		Subsidies to offset higher energy costs
to other enterprises and banks		-2.0	Subsidy cuts to lossmakers; bank recapitalization scaled down
Social policies	0.3	-0.2	Higher social support partially offset by improved targeting
Net lending		-0.1	Budgetary streamlining
Capital expenditure		-0.3	Budgetary streamlining
Total Impact/Measures	**-5.3**	**5.3**	

Source: Belarus authorities; and IMF staff calculations.

22. **The authorities indicated that fiscal policy would be geared toward maintaining macroeconomic stability.** They agreed fiscal policy had an important stabilizing role to play given the peg. Pointing to the lack of financing constraints, they saw no need to deviate from the fiscal goals identified in their medium-term program, arguing that fiscal policy should continue to support growth and meet social objectives, including through social transfers and public investment. However, they stressed that they would adjust policies to ensure macroeconomic stability, noting that the fiscal stance through May left room for tighter budget implementation. In this regard, they have not ruled out a moderate surplus in 2007, if required by economic circumstances.

23. **The authorities felt that it was premature to discuss the 2008 fiscal stance.** Macroeconomic stability will most likely require continued tight fiscal policies, depending also on monetary conditions and incomes policy. However, significant uncertainty remains. If growth slows down markedly, inflation pressures subside, and financing constraints are not binding, some fiscal stimulus might become appropriate.

24. **The government plans to streamline tax and expenditure policy next year.** They plan to abolish the distortive sales tax, various local fees, and lower the local retail trade tax, planning to partially offset the revenue loss by eliminating exemptions from the real estate tax and raising the VAT rate, or through spending restraint. The introduction of means-testing for transportation cost allowances, medicines, and sanatorium treatment will enhance the targeting of social support. The authorities also envisage phasing in a medium-term fiscal framework, building on good recent progress with enhanced program budgeting. Staff

welcomed these plans, but noted that the estimated 0.8 percent of GDP revenue impact of tax policy changes should be primarily offset through lower spending.

25. **Ageing, and other longer-term considerations argue for continued fiscal savings.** The UN projects working-age population to decline by 8.4 percent by 2020. Such looming demographic changes require saving the Social Protection Fund's surpluses. Rising health-care costs associated with ageing, the long-term costs of directed credits, and the need to avoid using one-off privatization receipts on current spending also call for building up net fiscal assets.

C. Exchange Rate and Monetary Policies

26. **The authorities did not agree that the real exchange rate was overvalued.** The NBRB noted that on a PPP basis, the real exchange rate appeared substantially undervalued. Given trading patterns, they argued for a larger weight for the real exchange rate vis-à-vis the Russian ruble, which would imply steady real effective exchange rate depreciation and improving competitiveness.[9] They did not see wages out of line with regional developments, in fact, they argued that as a percent of GDP, they were comparatively low. Pointing to the preponderance of the dollar in energy trade and capital flows, staff argued for a higher weight for the Br/US$ real exchange rate.

27. **The NBRB expressed confidence that it can maintain the peg—and achieve its inflation objective—even with continued rapid credit growth.** Pointing to diverging price indicators, the hiatus in dedollarization, and the widening current account deficit, staff argued that the change in the external environment and a loose policy stance had softened rubel money demand. Thus, more cautious credit policy was called for. The NBRB rejected staff's call for slowing credit growth to reign in domestic demand and inflation pressures. It contended that rapid credit growth—including an undiminished directed component—was critical for sustaining growth, and would not exacerbate inflation pressures given rising demand for rubels. The NBRB considered foreign borrowing by state-owned banks desirable, and argued that these inflows were commercial in nature, and should thus not be limited. The NBRB agreed with staff that moving government deposits to the central bank by end-2007 would be helpful in tightening liquidity.

28. **Staff argued that the fixed exchange rate regime required policy tightening to be viable.** With limited progress in structural reforms, supply in the economy may not be able to keep up with buoyant demand given the authorities' current policy plans. This in turn raises external financing needs and pressures on the peg. To keep these in check and bolster the credibility of the exchange rate anchor, policy interest rates should not fall in the near term and directed lending should be curbed, while wage and fiscal policies must be tightened.

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[9] Since 2000, the Br/RUR real exchange rate has depreciated by 33 percent while the Br/US$ real exchange rate has appreciated by 131 percent.

Policy tightening is also made necessary by the likely weakening of the authorities' control over capital flows. Pervasive state ownership has allowed them to control capital flows up to now, but privatization, particularly of banks, and the move toward more market-based financial relations with Russia might erode their ability to guide these flows.

29. **The NBRB also needs to prepare the ground for an alternative monetary policy regime.** It should continue to develop its monetary policy instruments and modeling capacities for inflation. Once liquidity management becomes more efficient and the depth of money markets is enhanced, a credible policy mix with liberalized price and wage setting can provide an alternative nominal anchor, possibly in the form of inflation targeting. This would pave the way toward greater exchange rate flexibility.

D. Financial Sector Policies

30. **The NBRB recognized that rapid credit growth, government operations through the banking system, and banks' surging foreign liabilities had increased risks to the financial sector.** It noted that sharply increasing credit has coincided with an almost doubling of the share of loss-making enterprises to 8.5 percent in 2006. Coupled with the worsened external environment, the increase in bank's net foreign liabilities, and growing balance sheet mismatches, credit and interest rate risks have increased. Stress test results indicated that losses could be substantial if these factors undermined borrowers' repayment ability, although capital adequacy ratios would remain above prudential norms. Moreover, in a scenario that encompassed a full pass-through of higher energy prices, several banks would fall below the minimum capital adequacy standard.

31. **Against this backdrop, the NBRB continues to improve the supervisory and regulatory framework.** In implementing the new Banking Code, it is tightening credit risk standards, improving bank governance, unifying licensing requirements and strengthening accounting and credit reporting standards. In progressing toward Basel II standards, it will move to consolidated risk-based supervision, and introduce new legislation on deposit insurance, payment operations, mortgages, and credit bureaus by 2008. Together with the elimination of the golden share rule for banks, such progress has raised foreign interest in the banking system, with two banks recently sold to Russian investors and the sale of further banks being discussed with interested foreign parties.[10]

E. External and Structural Policies

32. **The authorities expressed concern about ongoing trade disputes.** Despite recent progress, unresolved issues remain with Russia, and the European Union has rescinded its

[10] A golden share can be declared for any enterprise with current or past government ownership, entitling the government to take decisions regarding that enterprise.

preferential tariffs for about a tenth of Belarusian exports in mid-2007. Staff noted that trade liberalization, particularly through WTO accession, would best promote exports. In this context, it welcomed the authorities' commitment to making the domestic subsidy system WTO-compliant.

33. **The government has adopted a case-by-case approach to structural reforms, focusing on asset sales.** They have eschewed the golden share rule for Beltransgaz when they sold Gazprom a 50 percent stake and may drop its applicability in selected future cases. However, they rejected staff's view that this rule should be repealed for all enterprises. The authorities are considering further sales of breweries, pharmaceutical and petrochemical companies and banks, and have not ruled out liquidating some long-term lossmakers.

34. **Staff argued for wide-ranging structural reforms to raise productivity and contain macroeconomic risks.** In the near term, efficiency gains could stem from a substantial roll-back of administrative controls to strengthen price signals; and a hardening in enterprise budget constraints through cuts in enterprise subsidies. Moreover, given the planned acceleration of external borrowing, a strong system to monitor all external debt contracted or guaranteed by the public sector is important. Subsequently, a well-sequenced strategy is needed to attain a functioning market economy, with the following key elements:

- reducing the size of government by cutting taxes and streamlining expenditure while protecting the most vulnerable through targeted social assistance;

- creating a stable, predictable legal and business environment that ensures a level playing field for all investors; and

- implementing transparent privatization through open tenders to attract strategic private investors.

III. Staff Appraisal

35. **Belarus's macroeconomic performance and social development have so far been strong.** Growth averaged in double digits during 2004–06 and inflation fell below 7 percent last year. Moreover, Belarus's social indicators—notably its equal income distribution, high UN human development index and improving housing conditions—place it at the top of CIS league tables.

36. **This performance, however, has been colored by strong terms-of-trade gains.** These gains were a key factor behind the rapid expansion in output. Given little change in employment, productivity increased markedly as well—even though structural reforms lagged, FDI was low, and the introduction of advanced technologies was limited. High government-led investment also supported growth. The low profitability of SOEs and commercial banks however, shows that the efficiency of this investment is questionable.

Viewed in this light, the economy's supply response during the expansion and its overall performance was less buoyant.

37. **Looking ahead, the increase in energy import prices presents a significant challenge.** Past energy subsidies from Russia have hidden a deterioration in the underlying current account and a growing overvaluation of the real exchange rate. This suggests that policies were too expansive—even absent the new energy agreement. With the increase in energy prices in 2007 and further convergence toward European price levels in the medium term, a key source of growth and balance of payments support will be markedly reduced. Notably, the real exchange rate overvaluation might increase.

38. **The authorities have taken important steps in adjusting to the new external environment.** Fiscal policy played a critical role in saving some of the terms-of-trade gains in 2006 and its further tightening in 2007 was key for maintaining macroeconomic stability. Steps to lower wage growth, partially raise domestic energy prices, and eliminate the golden share rule in banking are welcomed. The authorities' proposed policy package also has positive elements, notably the commitment to further moderate wage growth and commence privatization transactions.

39. **However, the assumed supply response is overly optimistic and over-reliance on foreign financing rather than adjustment entails growing risks.** For the most part, the policy mix remains accommodative, with the current account deficit set to double to 8 percent of GDP in 2007. Credit growth, in particular, has remained strong. Adjustment is expected primarily through government-led investments aimed at export promotion, import substitution and energy savings—measures that take time to materialize and whose efficiency is unknown. The energy price pass-through is incomplete and real wages continue to rise. Thus the burden of adjustment rests mostly on enterprises through a squeeze on their profits—which raises the threat of decapitalization. Foreign financing appears to be available for some time and is a viable short-run response. However, this strategy delays necessary adjustment and structural reforms, and raises risks. Foreign financing is susceptible to sudden stops and, given the non-market based nature of some of Belarus's loans, subject to geopolitical risk. This strategy will also result in a sizeable buildup in debt—which is, to a worrisome extent, short term—and in the debt service ratio. Rapid credit growth will also raise pressure on banks, which cannot be shielded from macroeconomic strains and government intervention through stricter supervision and regulation.

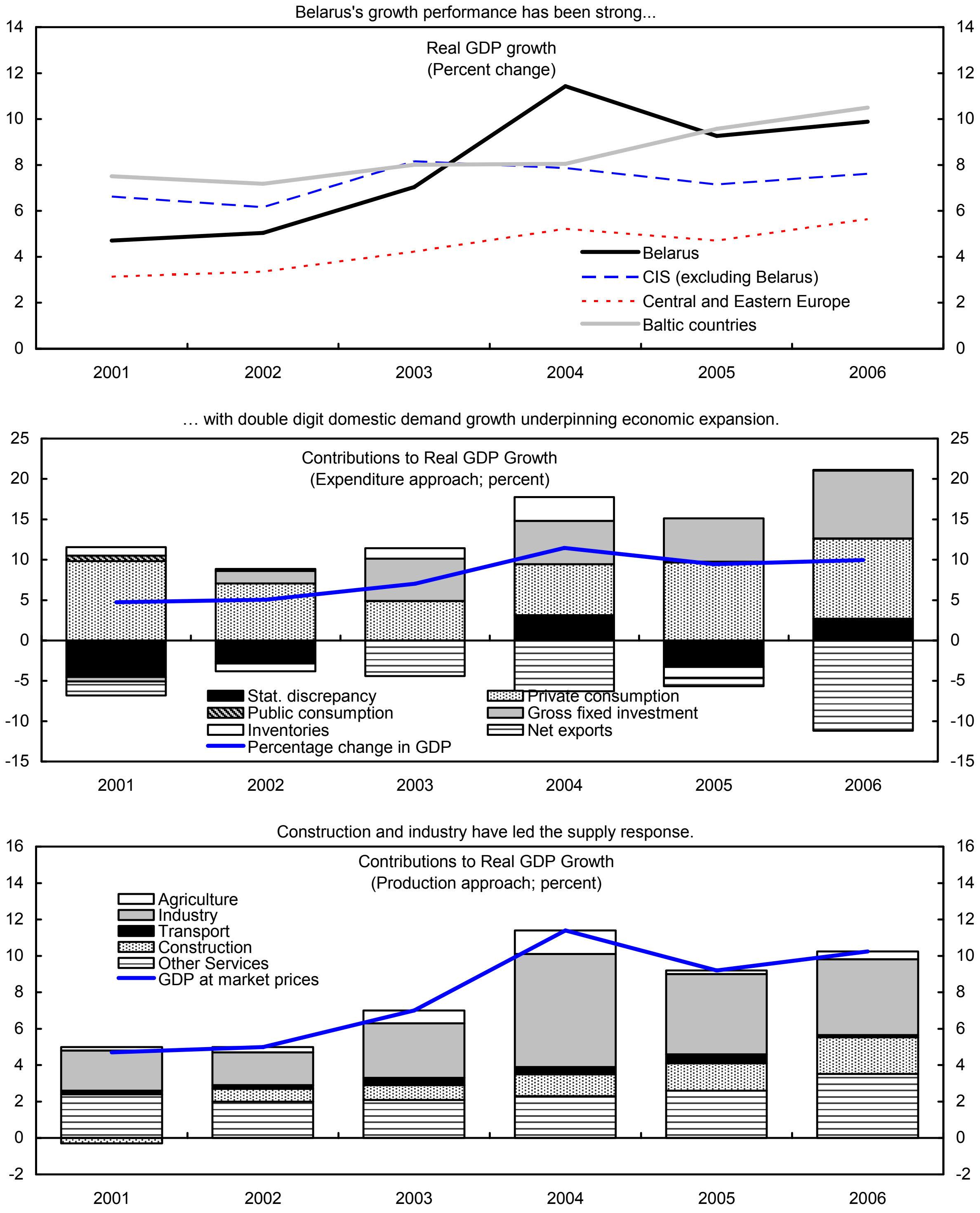
40. **A balanced policy package is needed to address the changed external environment.** The change is permanent, calling for early adjustment through a tighter policy mix—especially credit policies—to rein in domestic demand. Curtailing the still-rapid growth in real incomes is key. Real wages might need to decline to lower unit labor costs, especially if other elements of the policy mix remain expansionary. A higher energy price pass-through is also needed to boost energy efficiency. Equally important, structural changes are needed to strengthen the supply response and improve market flexibility through a

substantial roll-back of administrative controls. Financial system development would benefit from reducing the relative importance of state-owned banks.

41. **Policies as being implemented entail serious risks, which would escalate further if policies aimed for official targets.** The authorities want to maintain the peg as their nominal anchor. However, in the absence of structural reforms that could generate a strong supply response, aiming for budget deficits and marked real wage growth would result in widening current account deficits. These would raise pressures on reserves, and eventually force Belarus off the peg. Realizing this, the authorities have implemented stricter fiscal and wage policies than officially targeted in 2007 so far. Maintaining the peg while addressing the rubel's underlying overvaluation would require sustained tight demand management policies. These include adopting a neutral fiscal stance, compressing real wages, and phasing out directed lending. Fiscal consolidation, in particular, is critical—to support the nominal anchor, avoid excessive declines in national savings, and address looming demographic pressures as well as other long-term risks. Even with these policies, however, external debt would rise rapidly, GDP growth would slow markedly and the peg abandoned eventually. These outcomes, the associated risks, and the inevitable lag with which supply can be expected to increase point to the need for early implementation of fundamental structural reforms. They also indicate that the maintenance of the peg requires that real wage growth be kept well below productivity growth.

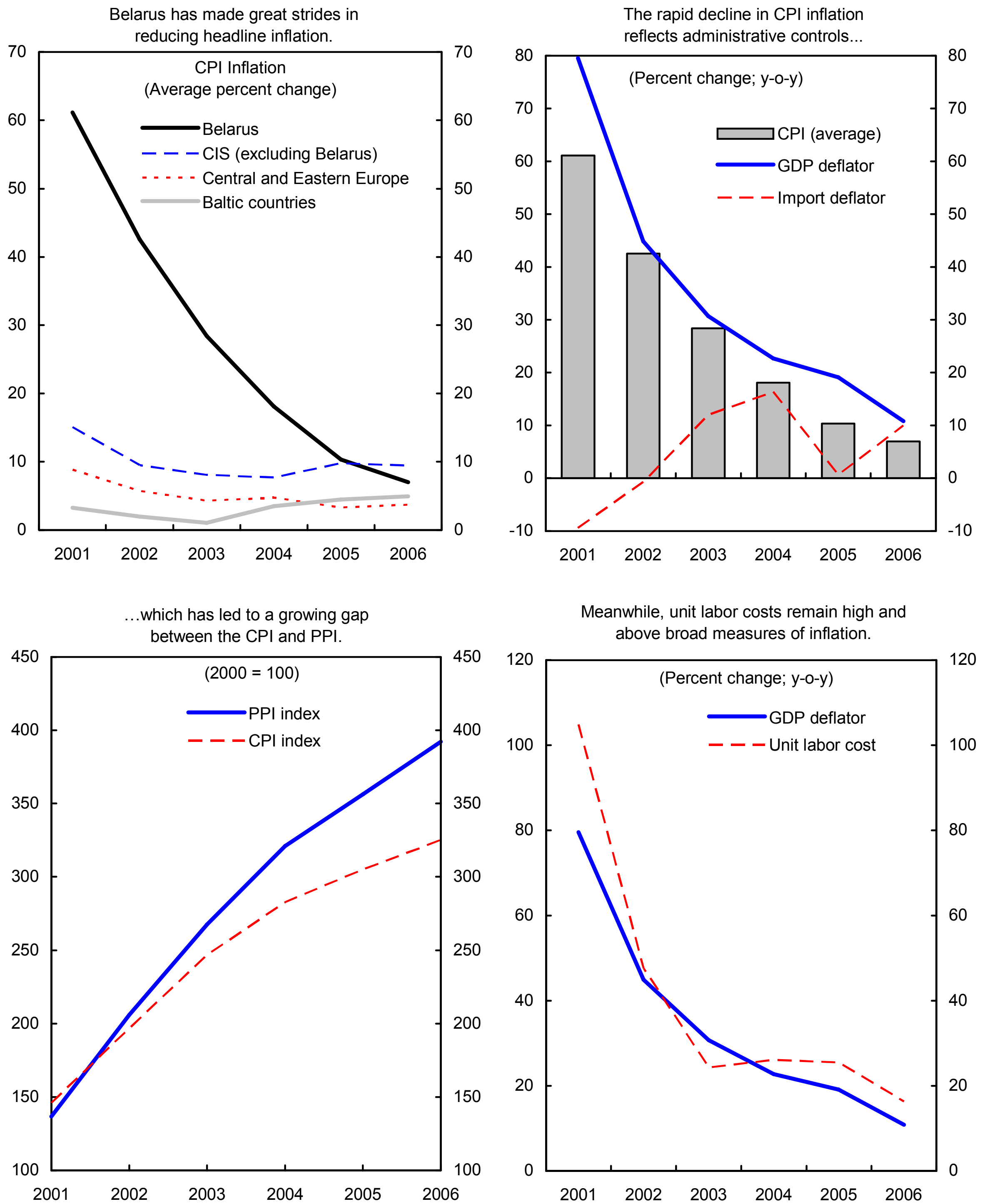
42. It is recommended that the next consultation occur on the standard 12-month cycle.

Figure 1. Belarus: Indicators of Real Activity, 2001–06



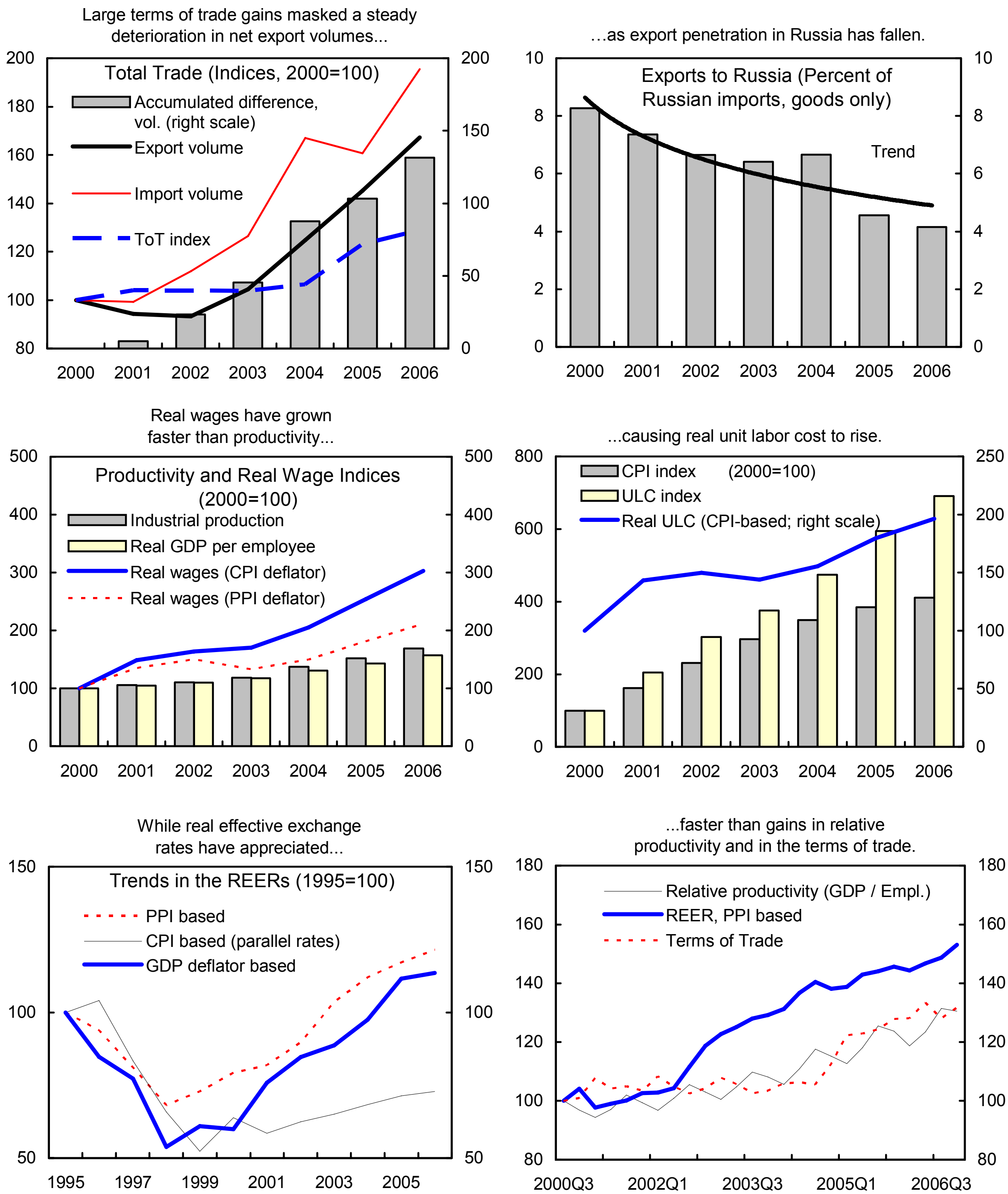
Sources: Belarus authorities; NBRB; IMF International Financial Statistics; and IMF staff estimates.

Figure 2. Belarus: Indicators of Inflation, 2001–06



Sources: Belarus authorities; IMF *International Financial Statistics*; and IMF staff estimates.

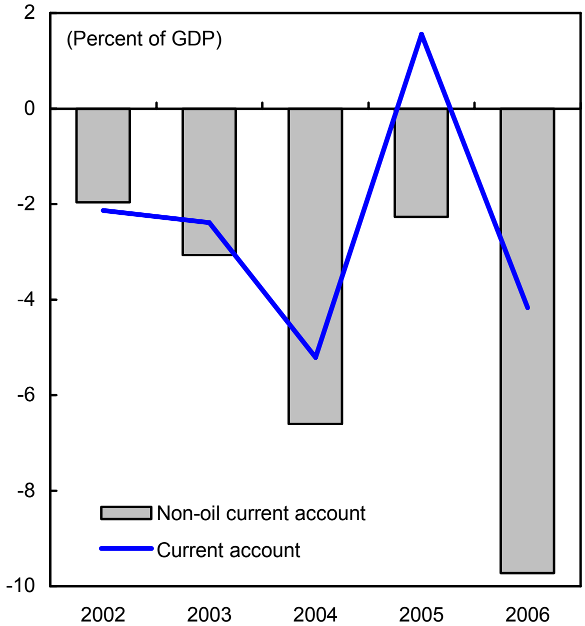
Figure 3. Belarus: External Competitiveness, 1995–2006



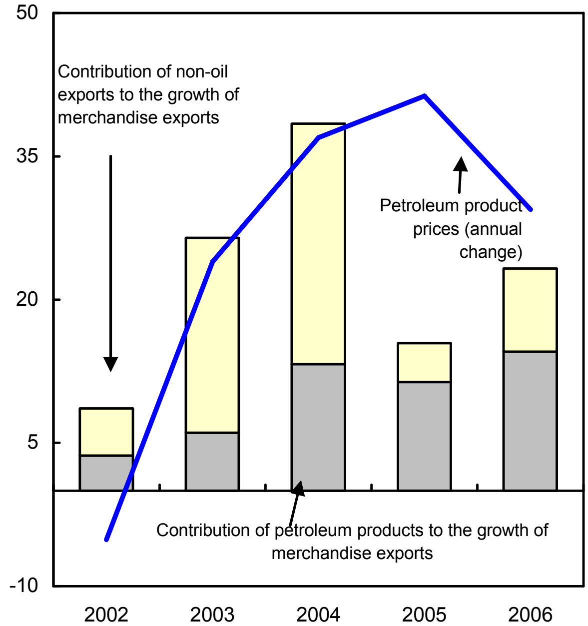
Sources: NBRB; and IMF staff estimates.

Figure 4. Belarus: Evolution of External Position, 2002–06
(Percent, unless otherwise indicated)

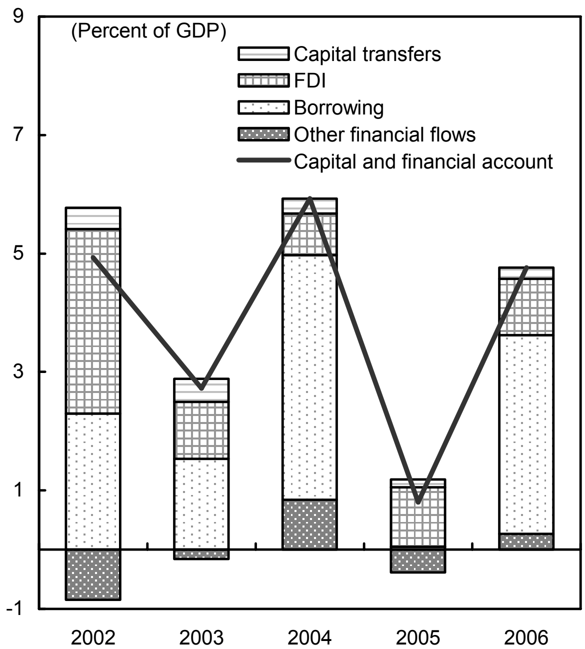
The current account swung from a modest surplus in 2005 to a deficit in 2006, driven by its non-oil components.



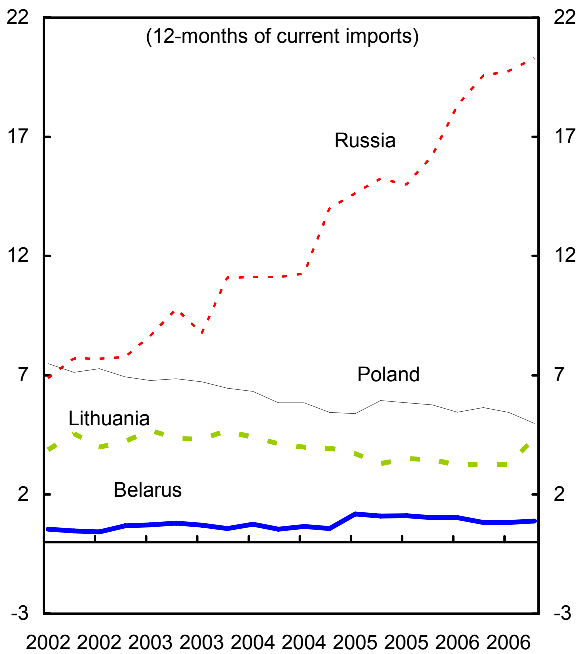
The contribution of oil products to exports rose rapidly.



Belarus attracted little FDI, so external borrowing dominated most financing.

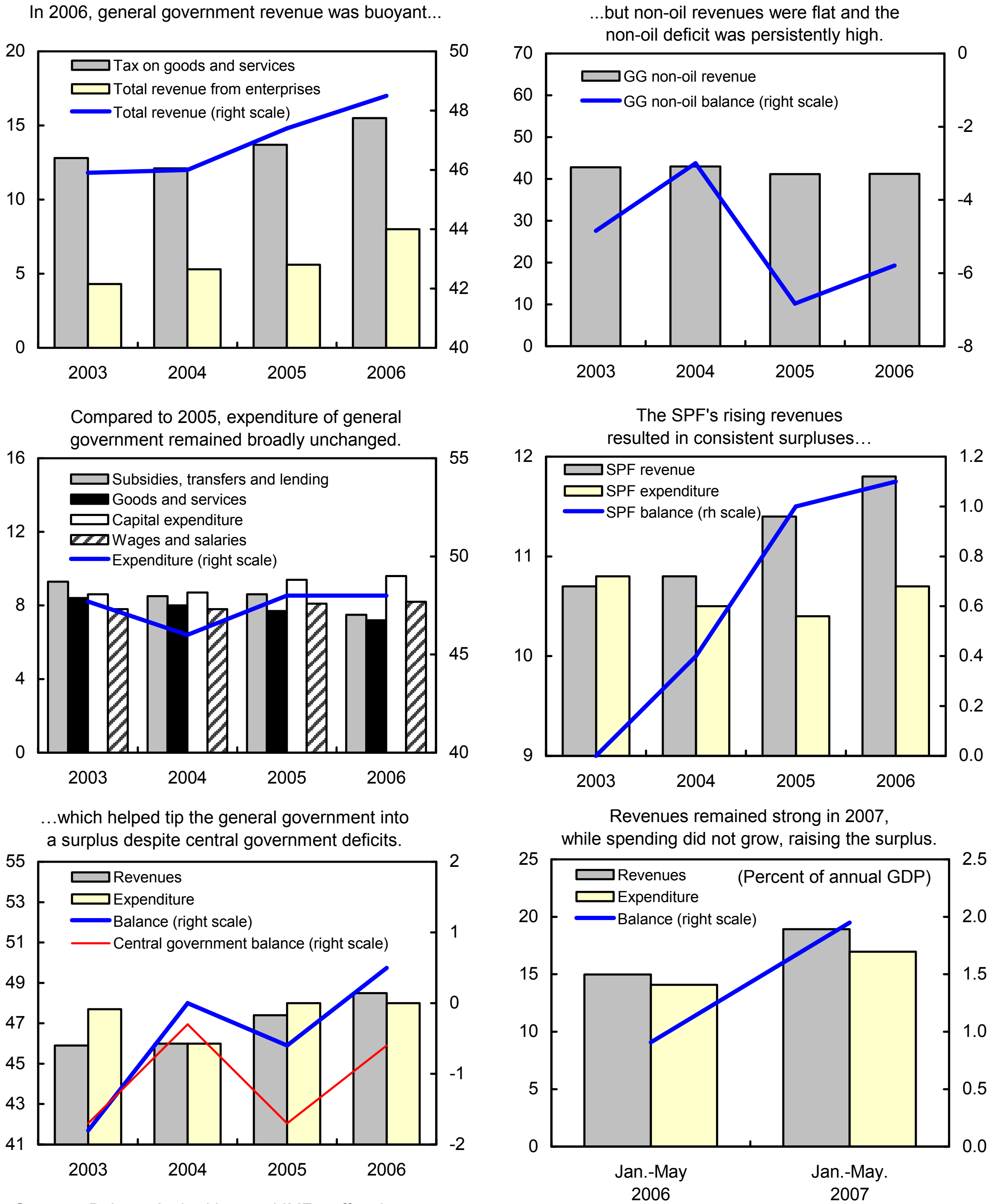


Meanwhile, foreign exchange reserves remained precariously low by international standards.



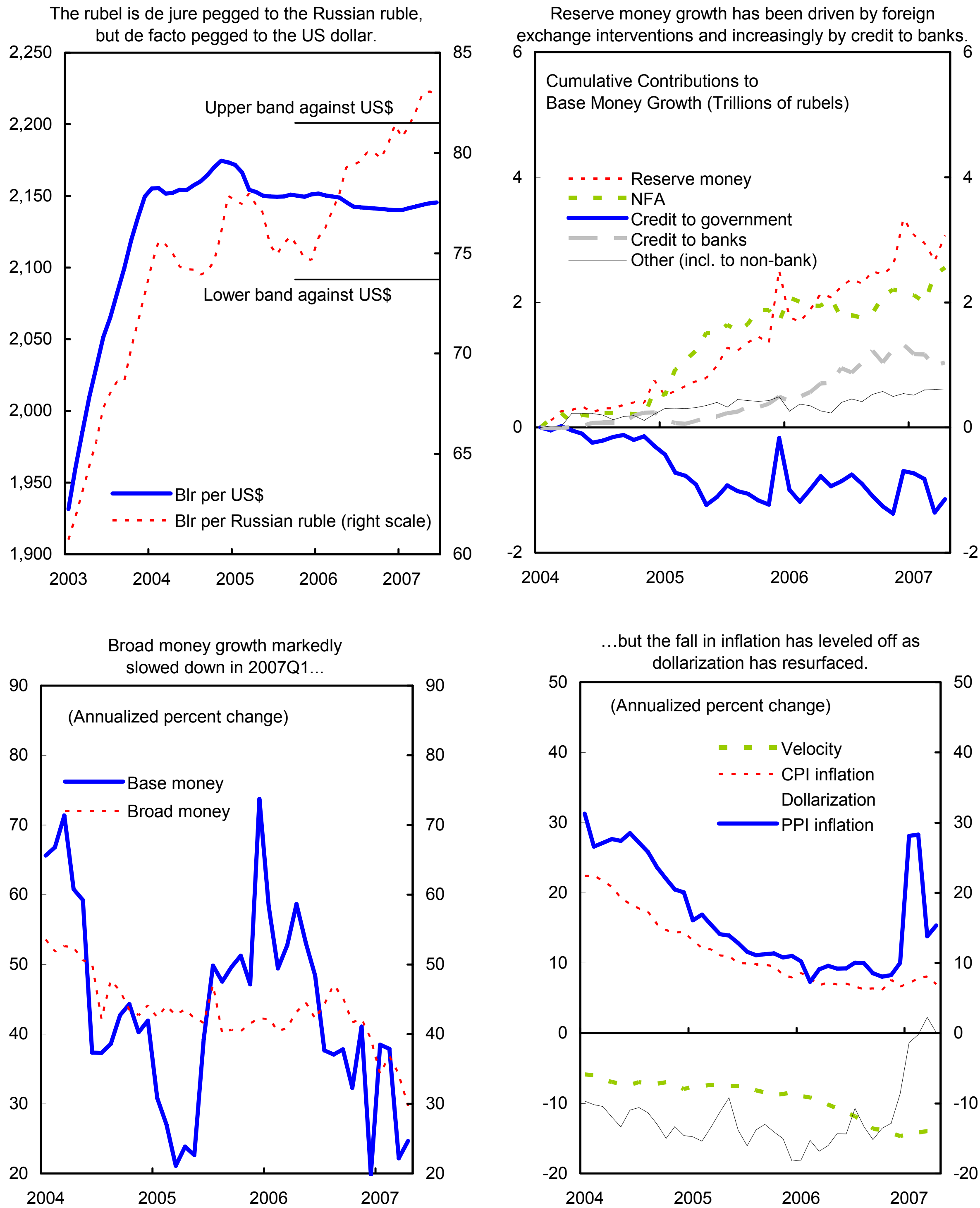
Sources: Belarus authorities; Haver; and IMF staff estimates.

Figure 5. Belarus: Fiscal Developments, 2003–07
(Percent of GDP)



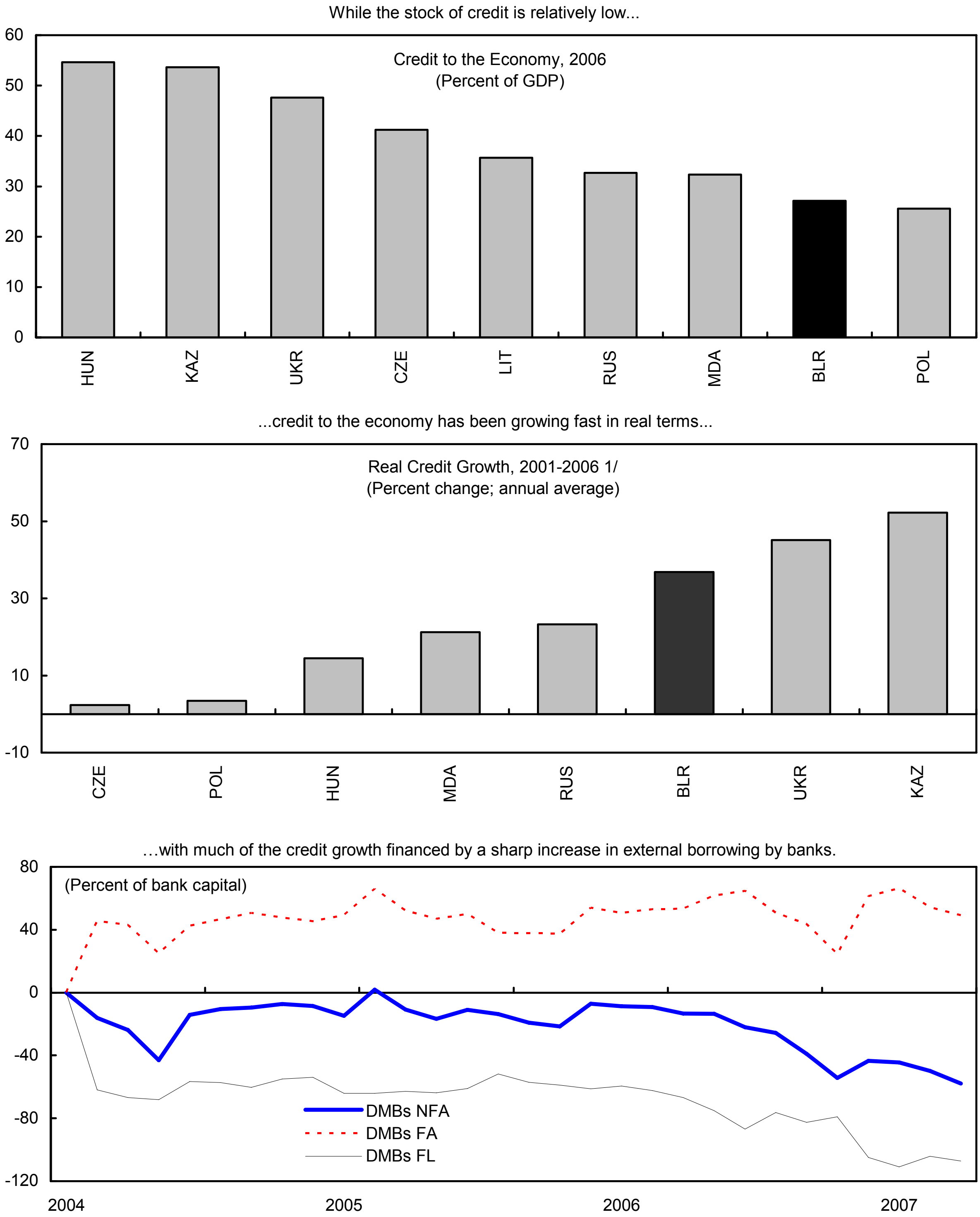
Sources: Belarus Authorities; and IMF staff estimates.

Figure 6. Belarus: Monetary Developments, 2003–07



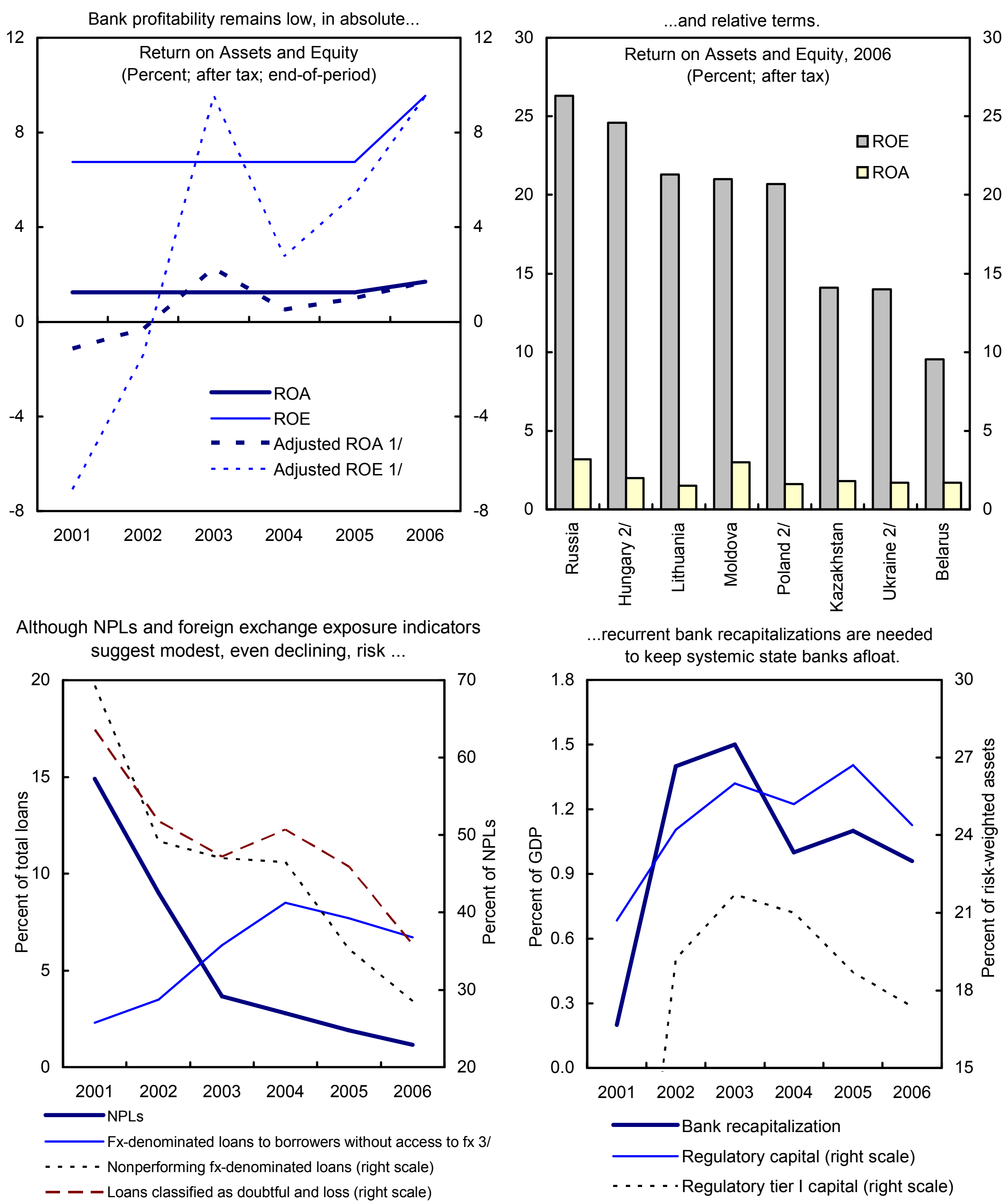
Sources: NBRB; and IMF staff estimates.

Figure 7. Belarus: Credit Developments, 2001–07



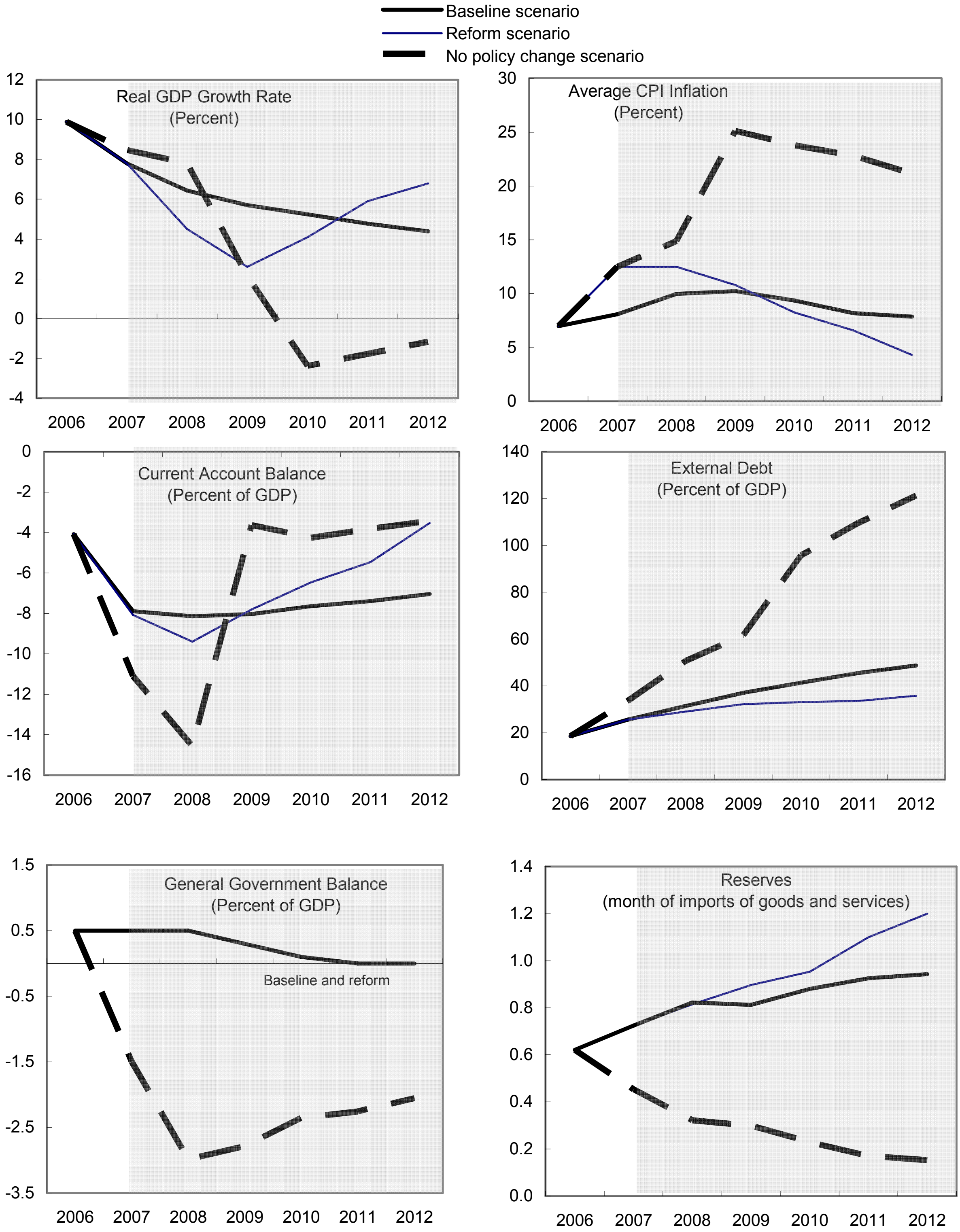
Sources: Belarus Authorities; and IMF staff estimates.
1/ Poland display average growth rates for 2001-2005.

Figure 8. Belarus: Banking Sector Developments, 2001–06



Sources: IMF *International Finance Statistics*; WEO; and IMF staff estimates.
1/ With required loan provisioning.
2/ Data are for 2005.
3/ Sectors with no access to foreign exchange are households, agriculture, and construction.

Figure 9. Belarus: Macroframework Scenarios



Sources: Belarus Authorities; and IMF staff estimates.

Table 1. Belarus: Selected Economic Indicators, 2003–12

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
				Prel.	Projections					
	(12-month change in percent, unless otherwise indicated)									
Output										
GDP (nominal; billions of rubels)	36,565	49,992	65,067	79,231	94,636	110,797	129,059	147,227	165,194	186,583
Gross domestic product (billions of U.S. dollars)	17.8	23.1	30.2	37.0	43.6	50.4	55.9	60.7	64.9	69.8
Real GDP	7.0	11.4	9.3	9.9	7.8	6.4	5.7	5.2	4.8	4.4
Industrial production	7.1	15.9	10.5	11.4	…	…	...	...	...	...
Prices and wages										
GDP deflator (year-on-year)	30.7	22.7	19.1	9.9	10.8	10.0	10.2	8.4	7.1	8.2
Consumer prices, end-of-period (year-on-year)	25.4	14.4	7.9	6.6	9.7	10.2	10.2	8.5	7.9	7.8
Consumer prices, period average	28.4	18.1	10.3	7.0	8.1	10.0	10.2	9.4	8.2	7.9
Wages (per month)	253.5	350.1	469.2	590.7	676.1	…	…	…	…	…
Real average wage (thousands of rubels, 1996=100)	238.7	279.0	338.6	377.2	377.2	…	…	…	…	…
Average wage (U.S. dollars)	116.3	129.1	156.8	175.7	173.8	…	…	…	…	…
Exchange rates										
Rubel/USD (average)	2,052	2,160	2,159	2,146	2,170	…	…	…	…	…
Rubel/USD (end-of-period)	2,156	2,170	2,152	2,140	2,200	…	…	…	…	…
Rubel/Ruble (RUR) (average)	66.8	75.6	76.4	78.8	81.6	…	…	…	…	…
Rubel/Ruble (RUR) (end-of-period)	73.2	77.9	74.9	81.1	79.3	…	…	…	…	…
	(Percent of GDP)									
General government finances 1/										
Revenue	45.9	46.0	47.4	48.5	48.1	48.0	47.7	47.5	47.1	46.7
Expenditure (cash)	47.7	46.0	48.0	48.0	47.6	47.5	47.4	47.4	47.1	46.7
Expenditure (commitment)	46.9	45.6	48.0	48.0	47.6	47.5	47.4	47.4	47.1	46.7
Balance (cash)	-1.7	0.0	-0.7	0.5	0.5	0.5	0.3	0.1	0.0	0.0
Balance (commitment)	-1.0	0.4	-0.6	0.5	0.5	0.5	0.3	0.1	0.0	0.0
	(12-month change in percent, unless otherwise indicated)									
Money and credit										
Annual average broad money velocity (level)	7.3	6.6	6.2	5.3	4.8	5.2	…	…	…	…
Annual average rubel broad money velocity (level)	13.5	11.2	9.6	7.5	6.5	6.6	…	…	…	…
Reserve money	69.7	41.9	73.7	19.8	30.7	28.0	…	…	…	…
Banking system net domestic credit	68.9	39.1	34.8	51.9	28.6	24.7	…	…	…	…
Rubel broad money	71.0	58.1	59.5	44.5	26.9	21.1	…	…	…	…
Refinance rate (percent per annum, end-of-period)	28.0	11.0	11.0	10.0	…	…	…	…	…	…
	(Millions of U.S. dollars, unless otherwise indicated)									
Balance of payments and external debt										
Exports of goods	10,073	13,942	16,095	19,838	21,035	23,572	26,551	29,964	33,748	37,841
Imports of goods	-11,329	-16,126	-16,623	-22,237	-25,307	-28,388	-31,636	-35,109	-38,974	-43,272
Current account balance	-424	-1,206	469	-1,512	-3,442	-4,102	-4,487	-4,640	-4,797	-4,915
Percent of 12-month GDP	-2.4	-5.2	1.6	-4.1	-7.9	-8.1	-8.0	-7.6	-7.4	-7.0
Terms of trade index (annual percentage change)	0.1	2.6	12.8	3.8	-17.4	-1.9	-4.6	-1.8	-0.3	-2.5
Gross official reserves	499	770	1297	1383	1810	2260	2710	3160	3560	3960
In months of future imports of goods and services	0.3	0.5	0.7	0.6	0.7	0.8	0.9	0.9	0.9	0.9
External debt (percent of GDP)	23.7	21.5	17.2	18.6	25.6	31.4	37.1	41.4	45.5	48.8
Short-term external debt (percent of GDP)	15.6	16.6	12.1	14.2	15.4	16.5	17.9	19.6	21.3	22.8

Sources: Belarus authorities; and IMF staff estimates.

1/ Consolidates the state government and Social Protection Fund budget.

Table 2. Belarus: Monetary Accounts, 2003–08

(Billions of Belarussian rubels, unless otherwise indicated; end-of-period)

	2003	2004	2005	2006	2007	2008
				Prel.	Staff projections	
Accounting exchange rate (Rubel per U.S. dollar)	2,156	2,170	2,152	2,140	2,200	…
Monetary authorities (NBRB)						
Net foreign assets	1,296	1,872	2,978	3,454	6,300	7,190
Foreign assets	1,947	2,057	3,009	3,480	6,651	7,541
Foreign liabilities	-650	-184	-31	-27	-352	-352
Net domestic assets	390	522	1,181	1,530	215	1,150
Net domestic credit	872	820	1,405	1,828	683	1,619
Net credit to government	516	199	325	-204	-3,067	-5,572
Claims on banks	332	565	818	1,649	3,070	6,510
Other claims on economy	24	56	262	382	681	681
Other items, net	-482	-298	-224	-297	-468	-468
Reserve money	1,687	2,394	4,159	4,984	6,515	8,340
Rubel reserve money	1,643	2,281	3,904	4,766	6,315	8,140
Of which: currency outside banking system	926	1,339	2,016	2,818	3,852	5,317
Non-rubel reserve money	44	113	255	218	200	200
Monetary Survey						
Net foreign assets	1,163	1,523	2,654	1,425	1,899	1,310
Foreign assets	2,666	3,044	4,484	4,399	7,800	8,707
Foreign liabilities	-1,503	-1,521	-1,830	-2,974	-5,901	-7,397
Net domestic assets	4,969	7,316	9,916	16,081	21,895	27,332
Net domestic credit	7,355	10,234	13,796	20,956	28,443	33,487
Net credit to general government	977	259	315	-139	-3,057	-5,658
Claims on economy	6,378	9,974	13,481	21,095	28,975	39,145
Other items, net	-2,386	-2,918	-3,880	-4,947	-6,548	-6,155
Broad money	6,132	8,839	12,571	17,506	23,794	28,642
Rubel broad money	3,408	5,388	8,595	12,416	16,761	20,289
Currency outside banks	926	1,339	2,016	2,818	3,852	5,317
Domestic currency deposits	2,269	3,949	6,449	9,503	12,725	14,739
Bank securities (outside banks), in rubels	213	100	129	94	184	234
Foreign currency deposits	2,705	3,426	3,952	5,051	6,982	8,302
Bank securities (outside banks), in rubels	16	21	20	35	45	45
Precious metals in deposits	3	3	4	4	5	5
12-month percent change in broad money	56.3	44.1	42.2	39.3	35.9	20.4
12-month percent change in rubel broad money	71.0	58.1	59.5	44.5	35.0	21.1
12-month percent change in reserve money	69.7	41.9	73.7	19.8	30.7	28.0
12-month percent change in rubel reserve money	84.9	38.9	71.1	22.1	32.5	28.9
12-month percent change in claims on economy	58.9	56.4	35.2	56.5	37.4	35.1
Annual rubel broad money velocity 1/	13.5	11.2	9.6	7.5	6.5	6.6
Annual broad money velocity 1/	7.3	6.6	5.9	5.3	4.6	4.7
Broad money multiplier	3.6	3.7	3.0	3.5	3.7	3.4
Rubel broad money multiplier	2.1	2.4	2.2	2.6	2.7	2.5

Sources: National Bank of Belarus; and IMF staff estimates.

1/ Defined as annual GDP divided by average broad (rubel broad) money for the year.

Table 3. Belarus: Fiscal Indicators and Projections, 2003–12

(Billions of rubels, unless otherwise indicated)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Projections					
1.State (republican and local) budget										
Revenue	12,875	17,587	23,420	29,007	34,315	40,076	46,355	52,597	58,355	65,192
Personal income tax	1,025	1,404	1,882	2,480	2,621	3,069	3,614	4,122	4,460	5,038
Profit tax	935	1,625	2,366	3,141	3,083	3,610	4,259	4,858	5,286	5,971
VAT	2,897	3,815	5,895	7,365	8,689	10,083	11,615	13,250	14,702	16,606
Excises	838	1,122	1,368	2,830	2,744	3,213	3,743	4,270	4,791	5,038
Property tax	731	957	1,149	1,268	1,514	1,773	2,036	2,267	2,379	2,687
Customs duties	957	1,095	1,682	2,069	4,732	5,540	6,453	7,214	8,260	9,329
Other	2,609	3,662	4,008	3,312	4,117	4,923	5,601	6,397	7,013	7,836
Budgetary funds 1/	2,884	3,910	5,071	6,543	6,814	7,867	9,034	10,218	11,464	12,688
Expenditure (cash)	13,495	17,758	24,521	29,518	34,822	40,326	46,843	53,437	59,463	66,416
Defense	377	472	698	999	1,230	1,440	1,678	1,914	2,148	2,426
Law, order and security	656	921	1,262	1,719	2,082	2,438	2,839	3,239	3,634	3,918
Agriculture	523	767	1,180	3,308	1,798	2,105	2,452	2,797	2,973	3,172
Housing and communal services	946	1,175	1,349	1,674	2,082	2,327	2,710	3,092	3,469	3,918
Education	2,352	3,020	4,060	4,788	5,722	6,699	7,803	8,901	9,988	11,281
Health	1,692	2,240	3,183	3,528	4,215	4,935	5,748	6,558	7,358	8,311
Social policies	615	821	1,396	2,140	2,555	2,992	3,485	4,122	4,791	5,411
Interest due	175	210	215	393	564	771	1,027	1,319	1,480	1,672
Budgetary loans	168	47	368	-155	189	111	129	147	165	187
Other	3,304	4,343	5,874	5,176	7,476	8,642	9,938	11,189	12,390	13,807
Other current expenditure			4,552	2,966	4,732	5,429	6,324	7,067	7,764	8,396
Capital investment			1,322	2,210	2,744	3,213	3,743	4,270	4,625	5,038
Budgetary funds 1/	2,687	3,743	4,894	5,948	6,908	7,867	9,034	10,159	11,068	12,314
Expenditure (accrual) 2/	13,228	17,587	24,478	29,519	34,822	40,227	46,843	53,437	59,463	66,416
Expenditure: economic classification 3/										
Wages and salaries	2,848	3,880	5,290	6,528	7,760	9,085	10,583	12,073	13,546	15,300
Social protection fund contributions	780	1,064	1,478	1,801	2,271	2,659	3,226	3,828	4,460	5,038
Goods and services	3,063	3,990	5,013	5,715	6,814	7,977	9,163	10,306	11,398	12,688
Interest	186	243	229	293	564	771	1,027	1,319	1,480	1,672
Subsidies and transfers	2,881	3,792	5,864	7,370	8,706	9,639	11,228	12,809	14,042	15,673
Capital expenditures	3,154	4,367	6,088	7,609	8,612	10,193	11,744	13,250	14,702	16,233
Net lending	336	258	559	203	95	-99	-129	-147	-165	-187
Domestic	383	313	646	335	189	12	258	294	165	187
Foreign	-47	-55	-87	-133	-95	-111	-387	-442	-330	-373
Balance (cash) 3/	-620	-170	-1,101	-511	-507	-249	-489	-841	-1,109	-1,224
Balance (accrual) 2/	-354	0	-1,058	-511	-507	-249	-489	-841	-1,108	-1,224
2. Social Protection Fund										
Revenue	3,921	5,417	7,405	9,384	11,167	13,074	15,229	17,373	19,493	22,017
Expenditure	3,931	5,226	6,735	8,491	10,221	12,298	14,326	16,342	18,337	20,711
Balance (cash)	-10	191	669	893	946	776	903	1,031	1,156	1,306
3. General government										
Revenue	16,796	23,004	30,825	38,392	45,482	53,151	61,583	69,969	77,848	87,209
Expenditure (cash)	17,426	22,984	31,257	38,010	45,043	52,624	61,169	69,780	77,800	87,127
Expenditure (accrual) 2/	17,160	22,813	31,214	38,010	45,043	52,624	61,169	69,779	77,800	87,127
Balance (cash) 3/	-630	21	-432	382	439	526	415	190	48	82
Balance (accrual) 2/	-364	191	-389	382	439	526	415	190	48	82
4. Statistical discrepancy 3/	-113	-53	-283	-27	0	0	0	0	0	0
5. Financing (cash) 3/	517	-73	149	-409	-439	-526	-415	-190	-48	-82
Privatization	36	40	45	-182	1,420	1,407	1,589	1,637	150	167
Foreign financing, net	-50	273	198	16	1,155	682	581	648	1,953	2,171
Domestic financing, net	531	-386	-94	-243	-3,013	-2,614	-2,584	-2,475	-2,151	-2,420
Banking system	453	-718	56	-455	-2,918	-2,601	-2,613	-2,455	-2,137	-2,427
NBRB	257	-318	126	-529	-2,863	-2,505	-2,721	-2,643	-2,251	-2,639
Banks (including SPF)	196	-400	-70	74	-55	-96	108	188	114	212
Nonbank	78	332	-150	212	-95	-13	29	-20	-14	7
Memorandum items:										
Government debt (trillions of rubels)	3.8	4.5	5.4	7.0	11.2	15.5	18.8	23.7	27.4	32.3
GDP (trillions of rubels)	36.6	50.0	65.1	79.2	94.6	110.8	129.1	147.2	165.2	186.6

Table 3. Belarus: Fiscal Indicators and Projections, 2003–12 (concluded)

(Percent of GDP, unless otherwise indicated)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Projections					
1.State (republican and local) budget										
Revenue	35.2	35.2	36.0	36.6	36.3	36.2	35.9	35.7	35.3	34.9
Personal income tax	2.8	2.8	2.9	3.1	2.8	2.8	2.8	2.8	2.7	2.7
Profit tax	2.6	3.2	3.6	4.0	3.3	3.3	3.3	3.3	3.2	3.2
Taxes on goods and services, o/w										
VAT	7.9	7.6	9.1	9.3	9.2	9.1	9.0	9.0	8.9	8.9
Excises	2.3	2.2	2.1	3.6	2.9	2.9	2.9	2.9	2.9	2.7
Property tax	2.0	1.9	1.8	1.6	1.6	1.6	1.6	1.5	1.4	1.4
Customs duties	2.6	2.2	2.6	2.6	5.0	5.0	5.0	4.9	5.0	5.0
Other revenue	7.1	7.3	6.2	4.2	4.4	4.4	4.3	4.3	4.2	4.2
Budgetary funds 1/	7.9	7.8	7.8	8.3	7.2	7.1	7.0	6.9	6.9	6.8
Expenditure (cash)	36.9	35.5	37.7	37.3	36.8	36.4	36.3	36.3	36.0	35.6
Defense	1.0	0.9	1.1	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Law, order and security	1.8	1.8	1.9	2.2	2.2	2.2	2.2	2.2	2.2	2.1
Agriculture	1.4	1.5	1.8	4.2	1.9	1.9	1.9	1.9	1.8	1.7
Housing and communal services	2.6	2.3	2.1	2.1	2.2	2.1	2.1	2.1	2.1	2.1
Education	6.4	6.0	6.2	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Health	4.6	4.5	4.9	4.5	4.5	4.5	4.5	4.5	4.5	4.5
Social policies	1.7	1.6	2.1	2.7	2.7	2.7	2.7	2.8	2.9	2.9
Interest due	0.5	0.4	0.3	0.5	0.6	0.7	0.8	0.9	0.9	0.9
Budgetary loans	0.5	0.1	0.6	-0.2	0.2	0.1	0.1	0.1	0.1	0.1
Other	9.0	8.7	9.0	6.5	7.9	7.8	7.7	7.6	7.5	7.4
Budgetary funds 1/	7.3	7.5	7.0	7.5	7.3	7.1	7.0	6.9	6.7	6.6
Expenditure (accrual) 2/	36.2	35.2	37.6	37.3	36.8	36.4	36.3	36.3	36.0	35.6
Wages and salaries	7.8	7.8	8.1	8.2	8.2	8.2	8.2	8.2	8.2	8.2
Social protection fund contributions	2.1	2.1	2.3	2.3	2.4	2.4	2.5	2.6	2.7	2.7
Goods and services	8.4	8.0	7.7	7.2	7.2	7.2	7.1	7.0	6.9	6.8
Interest	0.5	0.5	0.4	0.4	0.6	0.7	0.8	0.9	0.9	0.9
Subsidies and transfers	7.9	7.6	9.0	9.3	9.2	8.7	8.7	8.7	8.5	8.4
Capital expenditures	8.6	8.7	9.4	9.6	9.1	9.2	9.1	9.0	8.9	8.7
Net lending	0.9	0.5	0.9	0.3	0.1	0.0	-0.1	-0.1	-0.1	-0.1
Domestic	1.0	0.6	1.0	0.4	0.2	0.0	0.2	0.2	0.1	0.1
Foreign	-0.1	-0.1	-0.1	-0.2	-0.1	-0.1	-0.3	-0.3	-0.2	-0.2
Balance (cash) 3/	-1.7	-0.3	-1.7	-0.6	-0.5	-0.2	-0.4	-0.6	-0.7	-0.7
Balance (accrual) 2/	-1.0	0.0	-1.6	-0.6	-0.5	-0.2	-0.4	-0.6	-0.7	-0.7
2. Social Protection Fund										
Revenue	10.7	10.8	11.4	11.8	11.8	11.8	11.8	11.8	11.8	11.8
Expenditure	10.8	10.5	10.4	10.7	10.8	11.1	11.1	11.1	11.1	11.1
Balance (cash)	0.0	0.4	1.0	1.1	1.0	0.7	0.7	0.7	0.7	0.7
3. General government										
Revenue	45.9	46.0	47.4	48.5	48.1	48.0	47.7	47.5	47.1	46.7
Expenditure (cash)	47.7	46.0	48.0	48.0	47.6	47.5	47.4	47.4	47.1	46.7
Expenditure (accrual) 2/	46.9	45.6	48.0	48.0	47.6	47.5	47.4	47.4	47.1	46.7
Balance (cash) 3/	-1.7	0.0	-0.7	0.5	0.5	0.5	0.3	0.1	0.0	0.0
Balance (accrual) 2/	-1.0	0.4	-0.6	0.5	0.5	0.5	0.3	0.1	0.0	0.0
4. Statistical discrepancy 3/	-0.3	-0.1	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
5. Financing (cash) 3/	1.4	-0.1	0.2	-0.5	-0.5	-0.5	-0.3	-0.1	0.0	0.0
Privatization	0.1	0.1	0.1	-0.2	1.5	1.3	1.2	1.1	0.1	0.1
Foreign financing, net	-0.1	0.5	0.3	0.0	1.2	0.6	0.5	0.4	1.2	1.2
Domestic financing, net	1.5	-0.8	-0.1	-0.3	-3.2	-2.4	-2.0	-1.7	-1.3	-1.3
Banking system	1.2	-1.4	0.1	-0.6	-3.1	-2.3	-2.0	-1.7	-1.3	-1.3
NBRB	0.7	-0.6	0.2	-0.7	-3.0	-2.3	-2.1	-1.8	-1.4	-1.4
Banks (incl. SPF)	0.5	-0.8	-0.1	0.1	-0.1	-0.1	0.1	0.1	0.1	0.1
Nonbank	0.2	0.7	-0.2	0.3	-0.1	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Government debt/GDP	10.4	8.9	8.3	8.8	11.8	14.0	14.6	16.1	16.6	17.3
GDP (trillions of rubels)	36.6	50.0	65.1	79.2	94.6	110.8	129.1	147.2	165.2	186.6

Sources: Ministry of Finance, SPF, and IMF staff estimates.

1/ Includes innovation funds from 2002, formally incorporated into the state government budget from 2005.

2/ Includes changes in expenditure arrears.

3/ The actual deficits from above the line include all the closing expenditure for the year carried out in January of the following year and correspond to the authorities' fiscal year reports. The deficit values from the financing side include January closing expenditure in the year they were actually paid.

Table 4: Belarus: Balance of Payments (Baseline), 2003–12
(In millions of U.S. dollars, unless otherwise indicated)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-424	-1,206	469	-1,512	-3,442	-4,102	-4,487	-4,640	-4,797	-4,915
Merchandise trade balance	-1,256	-2,184	-527	-2,398	-4,272	-4,816	-5,085	-5,146	-5,226	-5,431
Exports	10,073	13,942	16,095	19,838	21,035	23,572	26,551	29,964	33,748	37,841
Imports	-11,329	-16,126	-16,623	-22,237	-25,307	-28,388	-31,636	-35,109	-38,974	-43,272
Services (net)	585	712	824	812	1,083	1,270	1,468	1,737	1,980	2,412
Income (net)	25	-19	16	-107	-442	-757	-1,083	-1,458	-1,799	-2,165
Transfers (net)	222	285	157	182	189	201	213	227	248	269
Capital and financial accounts	484	1,371	242	1,760	3,869	4,552	4,937	5,091	5,197	5,314
Capital account	69	58	41	71	80	82	102	104	107	110
Financial account	415	1,313	200	1,690	3,788	4,470	4,835	4,987	5,089	5,205
Direct investment (net)	170	163	303	351	797	793	791	797	614	618
Portfolio investment (net)	6	63	-42	-19	-19	-19	-19	-18	-19	-21
Trade Credits (net)	183	577	-353	186	341	383	441	515	542	569
Loans (net)	90	379	367	1,054	2,503	3,247	3,556	3,624	3,883	3,966
Other (net)	-35	132	-75	118	166	66	66	68	70	73
Errors and omissions	-14	277	-139	-250	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0	0	0	0	0
Overall balance	46	442	571	-1	427	450	450	450	400	400
Financing	-46	-442	-571	1	-427	-450	-450	-450	-400	-400
Gross official reserves	14	-256	-539	1	-427	-450	-450	-450	-400	-400
Use of Fund resources	-32	-17	-9	0	0	0	0	0	0	0
Exceptional financing 1/	-28	-169	-23	0	0	0	0	0	0	0
O/w: Central Bank of Russia (data needs to be checked)	12	-167	-53	0	0	0	0	0	0	0
Memorandum items:										
Current account (as percent of GDP)	-2.4	-5.2	1.6	-4.1	-7.9	-8.1	-8.0	-7.6	-7.4	-7.0
Trade balance (as percent of GDP)	-7.1	-9.4	-1.7	-6.5	-9.8	-9.6	-9.1	-8.5	-8.1	-7.8
Overall balance (as percent of GDP)	0.3	1.9	1.9	0.0	1.0	0.9	0.8	0.7	0.6	0.6
Y-o-y growth in exports of goods (in percent)	26.5	38.4	15.4	23.3	6.0	12.1	12.6	12.9	12.6	12.1
Y-o-y growth in imports of goods (in percent)	27.6	42.3	3.1	33.8	13.8	12.2	11.4	11.0	11.0	11.0
Y-o-y growth in imports of non-oil goods (in percent)	26.3	38.3	-6.2	36.0	6.5	8.8	11.2	14.4	15.2	16.1
Gross official reserves	499	770	1,297	1,383	1,810	2,260	2,710	3,160	3,560	3,960
In months of future imports of goods and services	0.3	0.5	0.7	0.6	0.7	0.8	0.9	0.9	0.9	0.9
External debt	23.7	21.5	17.2	18.6	25.6	31.4	37.1	41.5	45.5	48.8
Short-term debt (exc. portfolio) (as percent of GDP)	15.6	16.6	12.1	14.2	15.4	16.5	17.9	19.6	21.3	22.8
Debt service ratio (as percent of exports of goods and servic	5.3	3.8	3.4	2.6	3.4	5.0	7.0	9.0	10.4	11.0
Public and publicly-guaranteed debt service ratio (as percent of exports of goods and services)	2.2	2.3	0.8	0.5	0.5	0.5	0.6	0.7	0.7	1.0

Sources: Belarus authorities and IMF staff estimates.

1/ Includes accumulation, repayment, and forgiveness of arrears.

Table 5. Belarus: Indicators of External Vulnerability and Financial Soundness, 2003–07

(Percent of GDP, unless otherwise indicated)

	2003	2004	2005	2006	2007		
					Latest estimate	Date of latest observation	Proj.
Financial indicators							
Public sector debt	4.3	3.2	4.9	5.6	7.1	Q1/2007	8.0
Broad money (percent change, 12-month basis)	56.3	44.1	42.2	39.3	28.6	6/1/07	35.1
Private sector credit (percent change, 12 month basis)	58.9	56.4	35.2	57.0	57.3	6/1/07	35.9
31-day T-bill yield	32.4	18.3	13.4	10.3	10.7	Q1/2007	...
31-day T-bill yield (real)	4.0	0.2	3.1	3.3	3.3	Q1/2007	...
External indicators							
Exports (percent change, 12-month basis in U.S. dollars)	26.5	38.4	15.4	23.3	6.7	Q1/2007	6.0
Imports (percent change, 12-month basis in U.S. dollars)	27.6	42.3	3.1	33.8	21.6	Q1/2007	13.1
Terms of trade (percent change, 12 month basis)	0.1	2.6	12.8	3.8	...		-17.4
Current account balance	-2.4	-5.2	1.6	-4.1	-6.6	Q1/2007	-7.9
Capital and financial account balance	2.7	5.9	0.8	4.8	5.6	Q1/2007	8.9
Of which: inward portfolio investment (debt securities etc.)	0.0	0.3	0.0	0.0	0.0	Q1/2007	0.0
Other investment (loans, trade credits etc.)	1.7	4.9	0.0	3.9	6.9	Q1/2007	6.9
Inward foreign direct investment in the form of debt or loans	1.0	0.7	1.0	0.9	1.3	Q1/2007	1.9
Gross official reserves (millions of U.S. dollars)	499	770	1,297	1,383	1,720	6/1/07	1,810
Official reserves (months of imports of goods and services)	0.3	0.5	0.7	0.6	0.4	Q1/2007	0.7
Broad money to reserves ratio	6.0	5.3	4.5	5.9	5.0	6/1/07	6.1
Total short term external debt to reserves (ratio)	5.5	5.0	2.8	3.8	3.7	Q1/2007	3.7
Total external debt	23.7	21.5	17.2	18.6	17.5	Q1/2007	25.6
Of which: public sector debt	4.1	3.2	2.6	2.3	...		5.4
Total external debt to exports of goods and services (percent)	36.3	31.6	28.6	31.1	...		47.0
External interest payments to exports of goods and services (percent)	...	0.5	0.5	0.6	...		1.4
External amortization payments to exports of goods and services (percent)	...	3.2	3.1	2.0	...		1.9
Exchange rate (per U.S. dollar, period average)	2,052	2,160	2,159	2,146	2,145	6/1/07	...
Merchandise exports (constant prices, 12-month basis in U.S. dollars)	13.0	15.1	-1.7	9.2	...		4.6
Merchandise imports (constant prices, 12-month basis in U.S. dollars)	14.1	21.0	-1.4	23.9	...		-4.9
Financial market indicators							
Official risk indicators							
Share of non-performing loans in total loans	3.7	2.8	1.9	1.2	...		...
Risk-based capital asset ratio (capital over risk-weighted assets)	26.0	25.2	26.7	24.4	...		...
Financial sector risk factors							
Share of foreign exchange loans in total lending (percent)	50.4	43.8	37.0	33.8	...		...
Share of foreign deposits in total deposits (percent)	54.5	46.5	38.0	34.7	...		...
Share of foreign currency denominated liabilities in total liabilities (percent)	42.1	42.8	44.6	41.2	...		...
Average maturity of lending (months)	8.2	8.4	8.7	10.3	...		...
Average maturity of deposits (months)	3.6	4.2	5.3	8.7	...		...

Sources: Belarus authorities; and IMF staff calculations and estimates.

Table I.1. Belarus: External Debt Sustainability Framework, 2002–12

(Percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Debt-stabilizing non-interest current account 6/
Baseline: External debt	26.9	23.7	21.5	17.2	18.6	25.6	31.4	37.1	41.5	45.5	48.8	-1.6
Change in external debt	2.5	-3.3	-2.2	-4.2	1.4	7.0	5.8	5.7	4.4	4.0	3.3	
Identified external debt-creating flows (4+8+9)	-4.7	-3.4	-0.9	-7.5	0.0	4.8	5.2	5.0	4.6	4.6	4.3	
Current account deficit, excluding interest payments	1.8	2.0	4.9	-1.9	3.7	7.1	6.9	6.5	5.7	5.1	4.4	
Deficit in balance of goods and services	3.3	3.8	6.4	-1.0	4.3	7.3	7.0	6.5	5.6	5.0	4.3	
Exports	63.9	65.2	67.9	60.2	59.9	54.0	52.5	53.3	55.3	58.2	60.6	
Imports	67.2	69.0	74.2	59.2	64.2	61.3	59.5	59.8	60.9	63.2	65.0	
Net non-debt creating capital inflows (negative)	-3.1	-1.0	-0.7	-1.0	-0.9	-1.8	-1.6	-1.4	-1.3	-0.9	-0.9	
Automatic debt dynamics 1/	-3.3	-4.4	-5.1	-4.7	-2.8	-0.5	-0.2	-0.1	0.2	0.4	0.7	
Contribution from nominal interest rate	0.4	0.4	0.4	0.3	0.4	0.8	1.2	1.5	2.0	2.3	2.6	
Contribution from real GDP growth	-1.0	-1.6	-2.1	-1.5	-1.4	-1.2	-1.4	-1.6	-1.8	-1.9	-1.9	
Contribution from price and exchange rate changes 2/	-2.7	-3.2	-3.4	-3.4	-1.8	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	7.2	0.1	-1.3	3.3	1.4	2.2	0.7	0.7	-0.2	-0.6	-1.0	
External debt-to-exports ratio (percent)	42.1	36.3	31.6	28.6	31.1	47.4	59.9	69.6	75.0	78.2	80.4	
Gross external financing need (billions of U.S. dollars) 4/	2.5	3.4	4.5	3.9	5.6	9.1	11.5	14.0	16.5	19.1	21.6	
Percent of GDP	17.2	19.2	19.4	13.0	15.2	20.9	22.9	25.1	27.1	29.5	30.9	
Scenario with key variables at their historical averages 5/						25.6	27.7	29.1	29.2	28.5	28.0	-3.7
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.0	7.0	11.4	9.3	9.9	7.8	6.4	5.7	5.2	4.8	4.4	
GDP deflator in U.S. dollars (change in percent)	12.3	13.6	16.5	19.2	11.6	9.5	8.5	5.0	3.2	2.0	3.0	
Nominal external interest rate (in percent)	1.9	1.9	2.0	1.9	2.5	4.9	5.5	5.4	5.7	5.9	6.2	
Growth of exports (U.S. dollar terms, in percent)	9.8	24.4	35.7	15.6	21.9	6.4	12.2	12.6	12.7	12.5	12.1	
Growth of imports (U.S. dollar terms, in percent)	9.0	25.1	40.3	4.0	32.8	12.8	12.1	11.3	10.7	10.9	10.6	
Current account balance, excluding interest payments	-1.8	-2.0	-4.9	1.9	-3.7	-7.1	-6.9	-6.5	-5.7	-5.1	-4.4	
Net non-debt creating capital inflows	3.1	1.0	0.7	1.0	0.9	1.8	1.6	1.4	1.3	0.9	0.9	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in U.S. dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

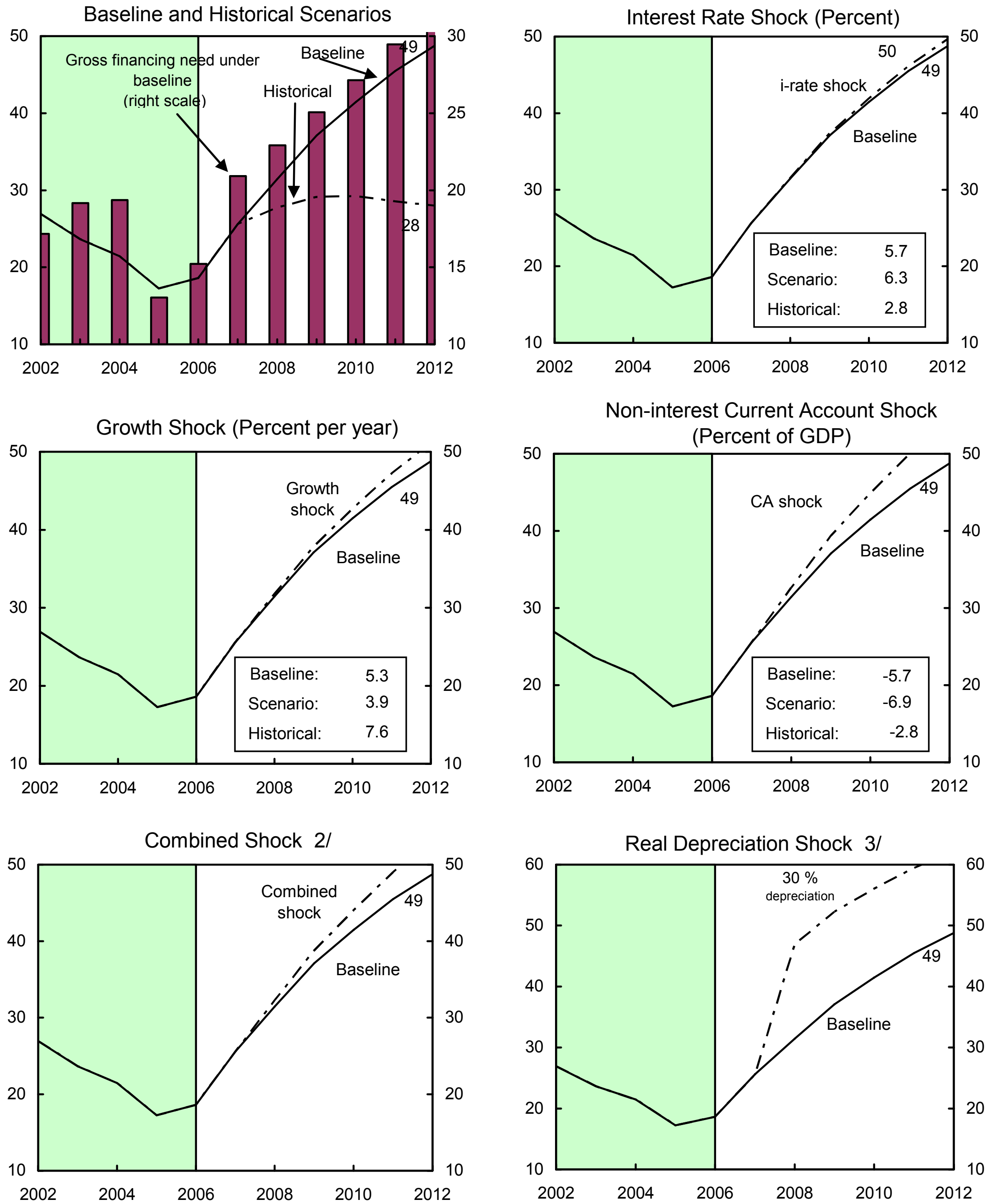
3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure I.1. Belarus: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2008.

Table II.2. Belarus: Public Sector Debt Sustainability Framework, 2002–12

(Percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	11.6	10.4	8.9	8.3	8.8	11.9	14.0	12.2	10.8	9.8	8.8	0.6
Of which: foreign-currency denominated	5.3	4.1	3.2	2.6	4.9	5.4	7.3	3.7	4.1	5.2	6.4	
Change in public sector debt	-1.7	-1.2	-1.5	-0.7	0.5	3.1	2.1	-1.8	-1.3	-1.0	-1.0	
Identified debt-creating flows (4+7+12)	-1.5	-0.3	-2.1	-0.5	-0.7	-2.4	-2.8	-2.5	-1.7	-0.3	-0.3	
Primary deficit	1.6	0.5	-0.8	0.3	-1.0	-1.1	-1.2	-1.1	-1.0	-0.9	-0.9	
Revenue and grants	44.5	45.9	46.0	47.4	48.5	47.9	48.0	47.7	47.5	47.1	46.7	
Primary (noninterest) expenditure	46.1	46.5	45.2	47.6	47.5	46.8	46.8	46.6	46.5	46.2	45.8	
Automatic debt dynamics 2/	-2.9	-2.2	-2.2	-1.8	-0.9	-0.8	-1.0	-1.2	-0.6	-0.3	-0.2	
Contribution from interest rate/growth differential 3/	-4.0	-2.8	-2.4	-1.7	-0.9	-0.8	-1.0	-1.2	-0.6	-0.3	-0.2	
Of which: contribution from real interest rate	-3.5	-2.2	-1.5	-1.1	-0.2	-0.3	-0.4	-0.5	0.0	0.2	0.2	
Of which: contribution from real GDP growth	-0.4	-0.6	-0.9	-0.6	-0.7	-0.6	-0.7	-0.7	-0.6	-0.5	-0.4	
Contribution from exchange rate depreciation 4/	1.1	0.6	0.2	0.0	0.0	...	...	...	...	...	...	
Other identified debt-creating flows	-0.2	1.4	1.0	1.0	1.2	-0.5	-0.6	-0.3	-0.2	0.8	0.8	
Privatization receipts (negative)	-1.6	-0.1	-0.1	-0.1	0.2	-1.5	-1.5	-1.2	-1.1	-0.1	-0.1	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	1.4	1.5	1.0	1.1	1.0	1.0	1.0	0.9	0.9	0.9	0.9	
Residual, including asset changes (2-3) 5/	-0.2	-0.9	0.6	-0.2	1.2	5.5	4.9	0.7	0.4	-0.7	-0.7	
Public sector debt-to-revenue ratio 1/	26.0	22.7	19.4	17.4	18.1	24.7	29.1	25.5	22.8	20.8	18.9	
Gross financing need 6/	3.4	2.1	0.6	1.4	0.4	0.7	0.9	1.0	1.0	1.0	0.9	
Billions of U.S. dollars	0.5	0.4	0.1	0.4	0.1	0.3	0.4	0.6	0.7	0.8	0.8	
Scenario with key variables at their historical averages 7/						11.9	13.3	10.8	8.4	6.4	4.8	-0.1
Scenario with no policy change (constant primary balance) in 2007-2012						11.9	14.1	12.2	10.8	9.5	8.3	0.6
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (percent)	5.0	7.0	11.4	9.3	9.9	7.8	6.4	5.7	5.2	4.8	4.4	
Average nominal interest rate on public debt (percent) 8/	6.8	5.8	5.5	4.8	7.3	8.1	6.9	6.6	8.4	9.3	10.3	
Average real interest rate (nominal rate minus change in GDP deflator, percent)	-38.1	-24.9	-17.2	-14.3	-2.6	-2.7	-3.1	-3.6	0.0	2.2	2.1	
Nominal appreciation (increase in US dollar value of local currency, percent)	-22.5	-13.1	-5.1	0.4	0.0	...	...	...	...	...	...	
Inflation rate (GDP deflator, percent)	44.9	30.7	22.7	19.1	9.9	10.8	10.0	10.2	8.4	7.1	8.2	
Growth of real primary spending (deflated by GDP deflator, percent)	2.4	7.7	8.5	15.1	10.4	6.4	6.3	5.2	5.0	4.1	3.5	
Primary deficit	1.6	0.5	-0.8	0.3	-1.0	-1.1	-1.2	-1.1	-1.0	-0.9	-0.9	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

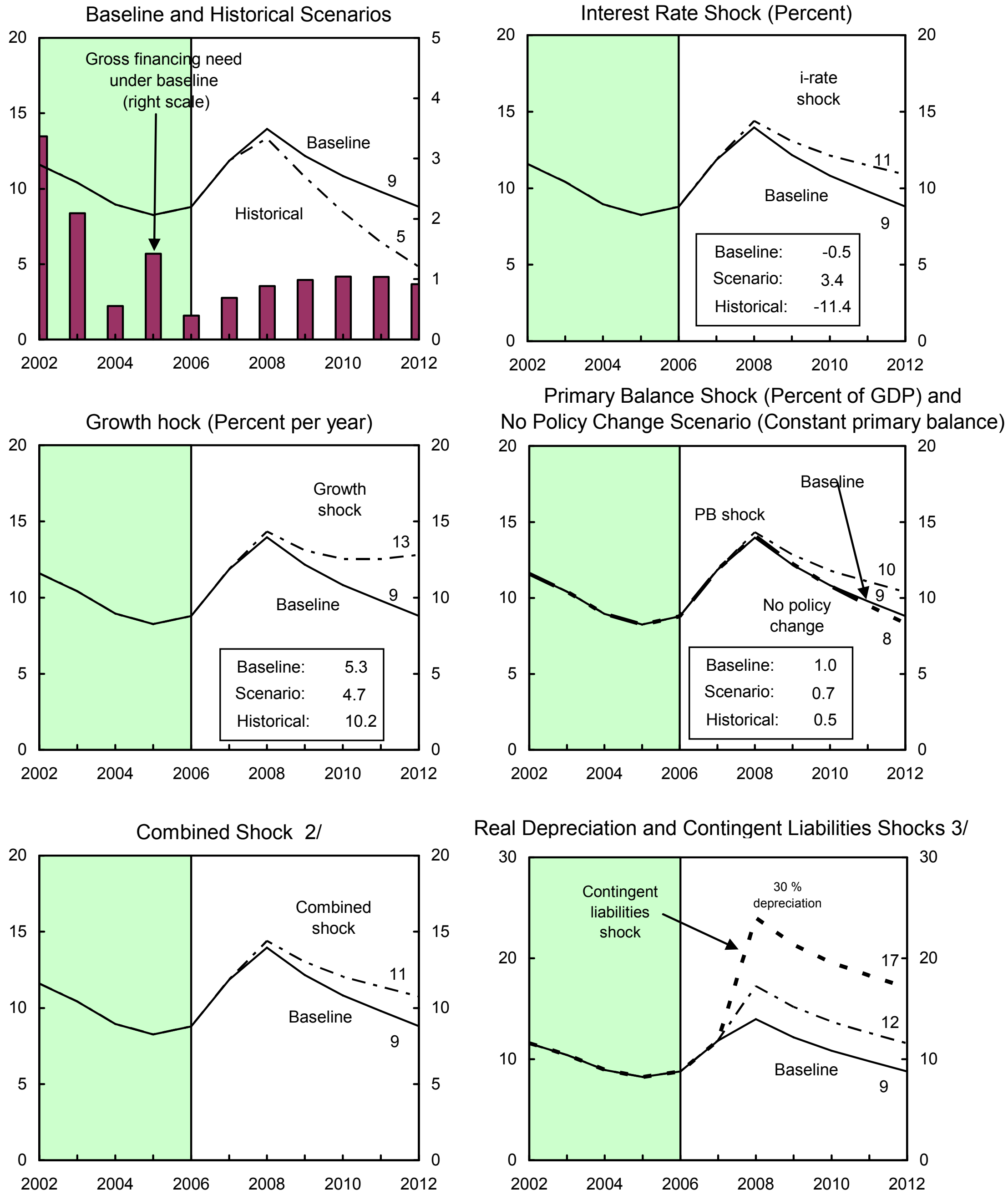
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP; three-year historical averages.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure II.2. Belarus: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2008, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

INTERNATIONAL MONETARY FUND

REPUBLIC OF BELARUS

Staff Report for 2007 Article IV Consultation—Informational Annex

Prepared by the European Department

August 10, 2007

Contents | Page

Annex I. Belarus: Fund Relations

As of May 31, 2007

Fund Relations: Belarus has accepted the obligations of Article VIII, Sections 2–4, and has no outstanding purchases (Appendix II). The authorities are not seeking a Fund program.

Exchange rate policy: The NBRB maintains a de facto peg to the U.S. dollar—the rubel exchange rate fluctuates within a band of ¼ percent around the pegged value. Section VIII describes the de jure arrangement.

Statistical database: Belarus's statistical data are adequate for surveillance, albeit with some shortcomings (Appendix III). Belarus subscribed to the SDDS in December 2004.

Consultation cycle: 12 months.

I. Membership Status: Joined July 10, 1992; Article VIII

II. General Resources Account:

	SDR million	Percent of Quota
Quota	386.40	100.00
Fund holdings of currency	386.40	100.00
Reserve position in Fund	0.02	0.01

III. SDR Department:

	SDR million	Percent of Allocation
Holdings	0.03	N/A

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-by	09/12/1995	09/11/1996	196.28	50.00

VI. Projected Obligations to the Fund (SDR million; based on existing use of resources and present holdings of SDRs): None

VII. Safeguards Assessments:

As there is no arrangement in place, under the Fund's safeguards assessments policy, the National Bank of Belarus (NBB) is not subject to a full safeguards assessment. However, as a potential borrower, the NBB requested a voluntary safeguards assessment, and an on-site assessment was conducted in December 2003. The assessment concluded that significant vulnerabilities existed in the safeguards framework, especially in the areas of the legal structure and independence, external and internal audit, and in financial reporting. The assessment made specific recommendations to correct the identified shortcomings. The authorities have begun to address some of these issues, and are considering appropriate measures to address the remaining concerns.

VIII. Exchange Arrangements:

As of August 20, 1994, the rubel (Br) became the unit of account replacing the Belarusian ruble, which was formally recognized as the sole legal tender only on May 18, 1994. The conversion took place at the rate of 10 Belarusian rubles = 1 rubel. The authorities decided to drop three zeroes from the rubel denomination as of January 1, 2000. The exchange rate for the U.S. dollar was Br 2,146 on August 10, 2007.

In mid-September 2000, the official exchange rate was unified with the market-determined rate resulting from daily auctions at the Belarus Currency and Stock Exchange. Since then, the official rate on any day is equal to the closing rate of the previous trading day. Since 2006, the exchange rate was set in the framework of horizontal corridors for the Russian ruble and the U.S. dollar around central parity. In 2007, the width of these corridors were ±4 percent vis-à-vis the Russian ruble, and ±2.5 percent vis-à-vis the U.S. dollar. On November 5, 2001, Belarus accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF's Articles of Agreement. During the same month, the NBB suspended all ad hoc exemptions from the 30 percent surrender requirement. Based on currently available information, Belarus does not maintain exchange restrictions or multiple currency practices.

IX. UFR/Article IV Consultation:

Belarus is on a 12-month consultation cycle. The 13th Article IV consultation was concluded on May 29, 2006. Subsequently, a staff visit occurred during February 7–14, 2007.

X. FSAP Participation, ROSCs, and OFC Assessments:

The fiscal ROSC was published on http://www.imf.org/external/pubs/cat/longres.cfm?sk=17839.0 and the data ROSC on http://www.imf.org/external/pubs/cat/longres.cfm?sk=18013.0. Two FSAP missions took

place in 2004 and an FSSA report was published on http://www.imf.org/external/pubs/cat/longres.cfm?sk=18367.0.
The detailed FSAPs were disseminated in May 2006 for the Basel Core Principles for Effective Banking Supervision on http://www.imf.org/external/pubs/cat/longres.cfm?sk=19246.0, for the Transparency of Monetary Policy and Banking Supervision on http://www.imf.org/external/pubs/cat/longres.cfm?sk=19248.0, and the Technical Note - Deposit Insurance on http://www.imf.org/external/pubs/cat/longres.cfm?sk=19250.0.

XI. Technical Assistance, 2000–07

	Department Counterpart	Subject	Timing
Missions	MCM	Banking supervision: on-site inspection	April 23–May 8, 2007
	MCM	Banking supervision: stress-testing, financial stability	March 26–30, 2007
	MCM	Insurance supervision	March 12–21, 2007
	MCM	Monetary policies analysis and forecasting	February 5–9, 2007
	MCM	Banking supervision: on-site inspection	January 17–26, 2007
	MCM	Improving monetary policy	January 15–17, 2007
	MCM	Monetary policies analysis and forecasting	October 23–27, 2006 October 9–13, 2006
	MCM	Banking supervision: on-site inspection	October 18–25, 2006
	MFD	International Accounting Standards	August 28–September 1, 2006
	MFD	Modeling capacity for supporting monetary policy implementation	March 27–31, 2006
	MFD	Banking Supervision	February 6–10, 2006
	MFD	Monetary Policy Transmission Mechanism	December 12–16, 2005
	MFD	International Accounting Standards	October 24–28, 2005
	MFD	Improving Monetary Policy	June 20–July 10, 2005
	MFD	Banking Supervision Issues	April 11–20, 2005
	MFD	Monetary Policy and Monetary Operations	February 26–March 10, 2005
	MFD	FSAP	September, November, and December 2004

	MFD/LEG	Anti-money laundering and combating the financing of terrorism legislative issues	June 17– 24, 2004
	MFD	Bank supervision and restructuring	December 1–12, 2003
	MFD	Issues in Monetary Unification with Russia	April 2–11, 2003
	MFD	Assessment of foreign exchange markets and operations and reserve management	June 2–10, 2002

	Department Counterpart	**Subject**	**Timing**
	FAD	Fiscal diagnostic mission	September 13–27, 2006
	FAD	Government Finance Statistics	April 28–May 12, 2005
	FAD/MFD	Improving debt management	October 6–20, 2004
	FAD	Budget code and other issues in public expenditure management	March 1–12, 2004
	FAD	Tax policy	March 19–April 1, 2003
	FAD	Public expenditure management	June 12–27, 2001
	FAD	Treasury development	January 15–26, 2001
	FIN	Safeguards Assessment	December 9–19, 2003
	STA	National accounts statistics	October 23–30, 2006
	STA	Monetary and Financial Statistics	October 19–November 1, 2005
	STA	National Accounts Statistics	January 10–21, 2005
	STA	Data ROSC and SDDS subscription	March 23–April 7, 2004
	STA	SDDS subscription	November 24-December 1, 2004
	STA	Balance of payments	August 20–September 3, 2003
	STA	Balance of payments	November 13–24, 2000
	STA	Money and banking statistics	October 25–November 7, 2000
	STA	Multisector statistics (report of the resident advisor)	August 7, 1996–August 6, 2000
	STA	National accounts statistics	August 23–September 6, 2000
Resident Advisors	STA	Mr. Umana (General Statistics Advisor)	August 1996–August 2000

ANNEX II. BELARUS: RELATIONS WITH THE WORLD BANK

Partnership in Belarus' development strategy

1. According to the recent Country Assistance Strategy for Belarus the World Bank Group aims to advance cooperation in critical areas, help the country open up its economy and society, minimize social and environmental risks, and address global public good concerns.

IMF-World Bank collaboration in specific areas

2. The Bank and Fund teams work closely in Belarus and maintain an extremely good relationship. The IMF plays a key role at the macro level, while the World Bank focuses on the structural agenda, energy efficiency, social and environmental issues. The Bank and the Fund teams carry out joint activities on the key fiscal and structural issues. The joint work on the Public Expenditure Review (PER), Financial Sector Assessment Program (FSAP) and the Country Economic Memorandum (CEM) - are examples of excellent cooperation between the two institutions.

Areas in which the World Bank leads

3. **Social sphere.** The World Bank technical engagement with Belarus has generated a significant amount of analysis in areas of relevance to the assessment of poverty and living conditions in the country. In 2004 the Bank presented study "Poverty Assessment. Can Poverty Reduction and Access to Services Be Sustained?" offering a number of improvements to the methodology for measuring poverty and living conditions in Belarus and contributing an in-depth analysis of the multiple dimensions of poverty. Driven by demographic and socio-economic factors, Belarus faces a need for deep pension system reform. To analyze current situation and discuss possible reform options the World Bank team conducted a *Pension Policy Dialogue* with the Government during FY 2004.

4. **Energy sector.** The *Social Infrastructure Retrofitting Project* (US$22.6 million) aims to assist in the rehabilitation of the heating system, thermal insulation, and lighting in over 450 public buildings across the country. The project targets schools, hospitals, orphanages and community homes for the elderly and the disabled. It also includes measures to increase energy efficiency. In September 2006 the Bank issued a report *Belarus: Addressing Challenges Facing the Energy Sector* which reviewed current standings of the electricity and gas sectors and proposed policy recommendations to mitigate the impact of gas price increases on the energy sector.

5. *Energy Sector Management Assistance Program grant* (US$50.0 thousand, completed in 2005). The project helped the Committee on Energy Efficiency explore market mechanisms to improve energy efficiency through operation of Energy Servicing Companies (ESCOs) and options of strengthening the energy efficiency program by learning experience of neighboring countries that have managed to weather the impact of multi-fold energy prices increases.

6. *Private-Public Infrastructure Advisory Facility project* (US$350.0 thousand) was approved in 2005**.** The project will help to advance the transition to market principles and encourage private sector involvement in the Belarus energy sector by providing regulatory, institutional and other support to create an environment that is conducive to private investment. While recognizing that the environment for private investments is not conducive in Belarus, the government has considered some reform scenarios that draw on experience gained by neighboring countries, and is seeking technical assistance in the evaluation and implementation of such scenarios.

7. **Environment.** Belarus has made good progress in the protection of environment. However, the country is still facing many environmental problems, including coping with the legacy of the Chernobyl accident. The *Post-Chernobyl Recovery Project* (approved on April 18, 2006) is designed to revitalize selected regions of the country, affected by the Chernobyl accident, by improving local people's living conditions, reinforcing the energy efficiency and environmental safeguards. The project is based on the recommendations of the *Chernobyl Review* (2002) and also intended to spearhead greater support of the international community to the affected regions of the country.

8. The government welcomes the Bank's continued support on the implementation of the Kyoto protocol which was ratified in November 2005. Pending the effectiveness of amendment to Annex B of the protocol, the country could be eligible to engage in joint initiatives program or carbon emission trading under the Kyoto Protocol. In the meantime, the Bank would assist the country in preparing for implementation of the Kyoto Protocol.

Areas of shared responsibility

9. **Economic development.** The Bank team cooperated closely with the IMF on the issues related to the preparation of the *Country Economic Memorandum (CEM)*, with one chapter - "Macroeconomic policies and risks," prepared jointly. This chapter reviews the country's macroeconomic developments since 1996, the sources and structure of growth, and analyzes the role of macroeconomic policies in Belarus's growth performance. Special attention was paid to the risks associated with Belarus's current macroeconomic position, and how these risks might be addressed effectively through adjustments in monetary policy, fiscal policy, and debt management.

10. **Private sector development.** The most challenging reform agenda for Belarus is in the area of structural reforms and private business development. The Bank Group seeks to improve the general environment for the creation and operation of private business in Belarus through technical assistance, policy dialogue and analytical work. The Bank and the IFC conducted a number of studies including *Improving the Business Environment* and *Costs of Doing Business Surveys* to track the developments in this area, define impediments to private business expansion and provide policy recommendations. The Fund focuses on macroeconomic policies aimed at sustainable growth and encouraging private sector development. The Fund also provides technical assistance to improve taxation, banking regulations and supervision of financial institutions.

11. **Public expenditure management**. The IMF and the Bank provide continuous technical assistance to Belarus in the area of public expenditure management. In FY 2006 the assistance has been provided for preparation of budget programs' description and other basic documents required for the introduction of performance-based budgeting (PBB).

12. The Bank is currently preparing a Public Expenditures Review (FY07) in the form of short policy notes, focused on two areas: (i) increasing efficiency in public capital expenditures; and (ii) reforming intergovernmental fiscal relations. Upon completion of the notes and in consultation with government, the Bank will determine specific areas that need further attention to produce just-in-time advisory notes.

14. **Financial sector.** The FSAP for Belarus (2005) has been centered on assessments of the banking system, including deposit insurance, securities markets, insurance industry, payment system and transparency in conducting monetary policy. Regulations, oversight and governance arrangements has been reviewed also. The Bank and the IMF also carry out joint responsibility for providing assistance to Belarus in the prevention of money laundering and combating financing of terrorism.

15. In the context of the CIS Payments and Securities Settlement Initiative (CISPI), the World Bank-lead mission visited Minsk in spring 2006 to review the payment and securities settlement systems of the Republic of Belarus. The CISPI is a cooperative effort lead by the World Bank. Its objective is to describe and assess the payments systems of the countries of the CIS with a view to identifying possible improvement measures in their safety, efficiency and integrity.

16. **Statistical capacity-building.** The IMF and the World Bank provide technical assistance in the area of statistics to the Ministry of Statistics and Analysis, National Bank and the Ministry of Finance. Trust Fund for Statistical Capacity Building grant (US$108.0 thousand, 2005) was designed to assist the government in the design of the National Strategy for the Development of Statistics.

Areas in which the IMF leads

17. The IMF is actively engaged with the Authorities in discussing the macroeconomic program providing them with technical assistance and related support, including on economic and financial statistics, tax policy, monetary operations and fiscal transparency. The IMF is leading the dialogue on setting the objectives for monetary and exchange rate policies, public debt management, overall budget envelope and tax policy.

18. The IMF analysis in these areas serves as an input to the Bank policy advice. The Bank and the IMF teams have regular consultations and the Bank staff takes part in the IMF Article IV Consultation missions. This helps to ensure consistency of the policy recommendations by the two institutions.

The World Bank Group Strategy

18. The last strategy program covered the period of 2002-2004. The Country Assistance Review (2004) recommended completing the key elements of latest CAS before initiation of the new strategy of engagement. This included: completion of ongoing ESW, particularly the CEM and the FSAP; continuation of the environment initiatives, and finalization of the Chernobyl Project. The new CAS for Belarus is currently under preparation.

19. To date, the Bank lending commitments in Belarus total US$243 million, with US$17.5 million provided as grants. The active portfolio includes two ongoing operations—the Social Infrastructure Retrofitting Project (US$22.6 million.) and the Post Chernobyl Recovery Project (US$50 million).

20. **The International Finance Corporation** has been actively involved in advisory work in Belarus since 1993. The work began with the advisory services on privatization of small businesses. Currently IFC focuses its efforts on small and medium enterprise development and improvement of the business environment.

21. IFC has invested a total of US$107 million in six projects, mostly over the course of the past five years, in the financial, agribusiness and retail sectors. In the financial sector, IFC has provided long-term funding to Priorbank and Belgazprombank to support their expansion and SME lending operations. By focusing on SME lending, financial sector investments have allowed IFC to reach a large number of private companies while strengthening the country's financial system.

Questions may be referred to **Sergiy Kulyk**, Country Program Coordinator, ECA Region, World Bank (202) 458-4068

ANNEX III. BELARUS: STATISTICAL ISSUES

1. The quality and timeliness of statistical data are broadly adequate for surveillance, although macroeconomic analysis is encumbered in some areas. The authorities have made significant efforts and improvements over the past years in a number of key areas, with the support of technical assistance from the Fund. As a subscriber to the SDDS since December 2004, Belarus disseminates regularly prescribed series, an advance release calendar and maintains a National Statistics Data Page (http://www.belstat.gov.by/homep/en/specst/np.htm). The provision of data over the last year has generally been adequate for the analysis of economic developments on a regular basis.

2. The data ROSC mission that visited Minsk in early 2004 found that all statistical agencies face the challenge of increasing users' confidence in the accuracy and reliability of official statistics.

National Accounts

3. National accounts are compiled in accordance with the *System of National Accounts of 1993* (*SNA 1993*). GDP is compiled by the production, the expenditure and the income approaches, and covers the entire economic territory of the Republic of Belarus. Data on GDP are disseminated on a quarterly basis (in national currency) in current and constant market prices (2000=100) expressed as absolute values.

4. In early 2006, the Ministry of Statistics and Analysis (Minstat) introduced a new methodology early 2006 for measuring industrial production in constant prices (on the basis of prices of the previous year). In October 2006, a national account mission reviewed the methodology. It found that it is remains essentially based on quantity measures and noted the limitations of such measures for dealing with issues such as the introduction of new products and improvements in quality. Besides, the methodology relies on a limited number of deflators to derive intermediate consumption in constant prices, that hamper a proper capture of volume and price breakdown and may introduce a systematic bias in measuring industrial output.

5. In addition, GDP figures are likely to be distorted by the underreporting of newly emerging sectors—in particular services—and an active informal sector. In addition, problems remain in calculating holding gains from inventories, and in measuring the capital stock and consumption of fixed capital. Estimates of GDP by expenditure categories are still uncertain as the statistical discrepancy has been soaring.

Prices

6. Data on Consumer Price Index (CPI) and the Producer Price Index (PPI) are being reported to the Fund monthly on a timely basis. Both indices were developed with substantial technical assistance from the Fund. As regards the PPI, in January 1995 a Laspeyres formula recommended by the Fund was adopted. Other recommendations, such as inclusion of exports, adequate specification of items, and better selection of representative products and prices, have either been adopted or are in the process of being adopted. Since January 2001,

the PPI has been compiled using the 1999 weights; and beginning with 2003 data, with 2001 production weights.

Government Finance Statistics

7. Since the 2004 data ROSC mission, the MOF has made progress in different areas of collection, compilation, and dissemination of fiscal data. The authorities have extended the coverage of the general government (republican and local government) operations by including data for innovation funds, included the Social Protection Fund's operations in the consolidated budget, increased the number of officials involved in the GFS compilation work, established a close coordination with the National Bank of the Republic of Belarus (NBRB) for the reconciliation of fiscal and monetary datasets, and increased provision of detailed budgetary metadata and methodological descriptions on the MOF's website. In addition to these improvements, the MOF has prepared new budgetary classifications codes for revenue, expenditure, and financing data that will align them to the *GFSM 2001* analytical framework.

8. At the end of April 2005, a GFS technical assistance (TA) mission visited Minsk. This mission found that the existing fiscal, accounting, and statistical systems have a sound basis for migrating to the *GSFM 2001*. Nonetheless, several areas were identified that will need further work before satisfactory implementation of the *GFSM 2001.* In order to provide assistance in this area, the GFS TA mission collaborated with the authorities on the preparation of a migration plan for a gradual implementation of this analytical framework.

9. The authorities have reported GFS for 2003 and 2004 under the *GFSM 2001* analytical framework for publication in the *GFS Yearbook* and started disseminating, through the MOF's website, fiscal data according to the IMF's Special Data Dissemination Standard.

Monetary Statistics

10. The balance sheet of the NBRB and the monetary survey are usually provided with a lag of no more than two weeks; the bank monthly balance sheet is available on or about the fifth of the month following the reference period, while monetary data for publication in *IFS* are reported with a lag of about four weeks.

11. Interest rate data on bank deposits and credits, as well as data on NBRB credit auctions and the placement of NBRB and government securities, are provided with a one-month lag. Exchange rate data are readily available on the NBRB's web site, and periodically reported to the Fund in electronic file.

12. Following STA technical assistance mission in October 2005, the NBRB compiles monetary statistics according to the methodology of the *Monetary and Financial Statistics Manual.* The NBRB reports monetary data to STA using the Standardized Report Forms (SRFs) framework. Monetary and financial data for Belarus in the SRF framework are available from December 2001 and have been published in the December 2006 issue of the *IFS Supplement.*

Balance of Payments Statistics

13. The overall quality and timeliness of external sector data is satisfactory. The International Transactions Reporting System employed by the NBRB has been broadened to permit a more accurate classification of external transactions, while coverage and reporting forms for enterprise surveys were also improved. The NBRB publishes quarterly balance of payments and international investment position statements in the *BPM5* format on a timely basis. Scheduled interest and amortization payments on public sector debt are tracked by the MoF and reported to the Fund, and timely information is available on arrears on government and government-guaranteed debt.

14. Belarus has started to disseminate historical data on the reserves template on the IMF's website: http://www.imf.org/external/np/sta/ir/colist.htm. Monthly time series start with November 2004 data.

BELARUS: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(AS OF JULY 27, 2007)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items[7]:	
						Data Quality – Methodological soundness[8]	Data Quality – Accuracy and reliability[9]
Exchange Rates	6/30/07	6/30/07	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	6/07	7/13/07	M	M	M		
Reserve/Base Money	5/30/07	6/22/07	M	M	M	O, O, LO, LO	O, O, O, O, O
Broad Money	5/30/07	6/22/07	M	M	M		
Central Bank Balance Sheet	5/30/07	6/22/07	M	M	M		
Consolidated Balance Sheet of the Banking System	5/30/07	6/22/07	M	M	M		
Interest Rates[2]	6/30/07	6/30/07	D	M	M		
Consumer Price Index	6/2007	7/18/07	M	M	M	O, LO, O, LO	O, O, LO, LO, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	5/2007	6/27/07	M	M	M	LO, LNO, O, O	O, O, O, O, NO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	5/2007	6/27/07	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	5/2007	6/27/07	M	M	M		
External Current Account Balance	3/2007	6/15/07	Q	Q	Q	O, O, LO, LO	LO, O, O, O, O,
Exports and Imports of Goods and Services	4/2007	06/13/07	M	M	M		
GDP/GNP	Q1/2007	7/18/07	Q	Q	Q	O, O, LO, O	LO, LNO, LO, O, LO
Gross External Debt	Q1/2007	6/13/07	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[7] These columns should only be included for countries for which a Data ROSC (or a Substantive Update) has been prepared.
[8] Reflects the assessment provided in the data ROSC (published on February 1, 2005, and based on the findings of the mission that took place during March 23–April 7, 2004) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[9] Same as footnote 8, except referring to international standards concerning source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF BELARUS

Staff Report for the 2007 Article IV Consultation

Supplementary Information

Prepared by the European Department

Approved by Michael Deppler and Anthony R. Boote

August 22, 2007

1. **This supplement provides updated information that has become available since the staff report was finalized.** Since Belarus is a 3(b) country under the Decision on Implementation of the 2007 Decision on Bilateral Surveillance, this supplement also provides a summary of the authorities' reaction to staff's assessment of real exchange rate misalignment. The new information does not change the thrust of the staff appraisal.

2. **Recent data confirm continued strong growth, inflation pressures, and a worsening trend in the current account balance.** Real GDP grew by 8.8 percent in January–July 2007 compared with the same period last year. Twelve-month CPI inflation remained low at 7.2 percent in June, but the PPI surged to 14.1 percent, reflecting energy price pass-through. Preliminary estimates for the current account deficit in the first half of 2007, at 2.7 percent of annual GDP, point to a marked deterioration from the 0.7 percent of GDP deficit recorded in the same period of 2006. This is broadly in line with the staff report's baseline projection.

3. **General government operations remained in surplus in January–June 2007.** The surplus of 1.9 percent of annual GDP is about double the average recorded in the first halves of the previous three years. It primarily reflects continued strong revenue performance.

General Government Operations in January-June
in percent of annual GDP

	Revenue	Expenditure	Balance
2004	20.0	19.4	0.6
2005	22.1	20.6	1.5
2006	22.0	21.0	1.0
2007	23.1	21.2	1.9

4. **The NBRB has continued to lower the refinance rate toward its end-2007 target.** On August 1, the NBRB cut the refinance rate again by 25 basis points to 10.5 percent, consistent with reaching its end-year target level of 9 percent. Credit growth continues to be high at a 12-month rate of 56.5 percent in June.

5. **The forthcoming 2008 Monetary Policy Guidelines envisage a streamlining of monetary policy targets.** The NBRB will no longer peg the Belarusian rubel de jure to the Russian ruble from January 1, 2008. Formalizing the de facto peg maintained in the past several years, the NBRB intends to peg the rubel to the U.S. dollar within a corridor of ±2.5 percent around central parity. In addition, it will drop M1 as an intermediate monetary

policy target, citing its weak correlation with inflation. Staff supports these moves as enhancing monetary policy transparency.

6. **On Aug. 21, 2007, Standard & Poor's Ratings Services assigned a 'B+' long-term foreign currency and a 'BB' long-term local currency sovereign credit rating to Belarus.** Short-term sovereign credits were rated 'B'. The outlook is stable. This first sovereign rating compares favorably to initial ratings for other CIS countries, being similar to those initially granted to Kazakhstan and Georgia.

7. **The authorities stressed uncertainties associated with staff's calculations regarding real exchange rate misalignment.** The authorities argued that owing to their planned offsetting policy measures, terms-of-trade losses from energy price increases would be smaller than the cumulative 10–15 percent of GDP estimated by staff for the period to 2012. They also project smaller current account deficits than those in staff's baseline scenario; and with higher expected FDI inflows, they project lower debt accumulation in the coming years. The authorities also point to their plans to ease the tax burden and reduce the energy and material intensity of production—factors they expect will improve Belarus's competitiveness.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 07/108
FOR IMMEDIATE RELEASE
August 30, 2007

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

IMF Concludes 2007 Article IV Consultation with the Republic of Belarus

On August 24, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Belarus.[1]

Background

Belarus's centralized economy grew rapidly over the past few years, enhancing social development. The state redistributed large and growing terms-of-trade gains stemming from favorable Russian energy pricing across the economy, boosting domestic demand. With available spare capacities, output expanded rapidly. Belarus's social indicators—notably its equal income distribution, high UN human development index, and improving housing conditions—place it at the top of the Commonwealth of Independent States league tables. A de facto exchange rate peg to the U.S. dollar anchored inflation expectations.

A new energy agreement, however, has abruptly reversed terms-of-trade gains. Belarus now pays Russia twice as much for gas supplies as in 2006 and a fifth more as a share of world market prices for crude oil. This results in an estimated loss of 5½ percent of GDP in 2007, of which about 1½ percentage points could be offset by higher export prices and lower energy intensity of production. Subsequent losses will be smaller, particularly if additional declines in energy intensity occur, but cumulative losses through 2012 may reach 10–15 percent of GDP.

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[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. This PIN summarizes the views of the Executive Board as expressed during the Executive Board discussion based on the staff report.

Growth and inflation performance remained favorable but resource constraints may be emerging. Growth accelerated to 9.9 percent in 2006 as rapid real wage gains supported consumption, while state-directed credit boosted investment. However, capacity utilization indicators, labor market data, and strong import demand signal incipient capacity constraints. Decelerating money growth, price controls, and the exchange rate anchor helped slow consumer price inflation to 6.6 percent by end-2006. Twelve-month inflation measured by Consumer Price Index—limited by tightened price caps—rose only marginally to 7 percent through May 2007, but producer prices increased by 13.5 percent.

The current account swung into deficit, raising reliance on foreign financing. Net export volumes fell sharply, reflecting declining non-oil export market penetration and rising unit labor costs. This pushed the current account from a surplus of 1.6 percent of GDP in 2005 to a deficit of 4.1 percent in 2006. The Q1 2007 deficit reached 1½ percent of annual GDP compared to a small surplus in Q1 2006. Foreign borrowing is increasing rapidly, raising external debt from its low end-2006 level of 19 percent of GDP. The National Bank of the Republic of Belarus (NBRB) has rebuilt its foreign exchange reserves to around one month of imports by July.

Fiscal prudence was a key component of the policy mix. Monetary conditions were accommodative in 2006, and again from April 2007. Pressure on the peg—owing to concerns over new energy prices—forced the NBRB to raise policy rates in early 2007. But annualized credit growth picked up substantially, exceeding 50 percent in real terms by end-April, financed increasingly through rising foreign borrowing and government deposits in 2007. Directed concessional lending through state-owned banks facilitated by large government deposits, and government-mandated wage increases in excess of productivity at state-owned enterprises continued to provide an underlying expansionary impulse to the economy. However, wage growth has been scaled back in 2007, although not yet commensurately with the economy's permanent income loss. The fiscal stance also turned contractionary as the general government moved from a deficit of 0.6 percent of GDP in 2005 to a surplus of 0.5 percent in 2006. During the first five months of 2007, the surplus reached 1.7 percent of annual GDP. Finally, the government limited the pass-through of higher energy import costs to domestic prices to about 60 percent.

Against this background, staff's assessment is that the real exchange rate has become overvalued by about 10 percent.

Financial soundness indicators appear adequate in the state-dominated banking system. The share of nonperforming loans is small. Banking system net domestic assets—at 20 percent of GDP—remain relatively low and largely short term, with over 80 percent controlled by four large state banks. Their profitability is relatively low, and their recurrent recapitalizations fall short of the long-run costs of directed lending, imperiling their solvency.

Progress with structural reforms has been limited and the state's role in the economy remains dominant. Administrative restrictions on price formation, private sector activity and the movement of labor hamper market flexibility.

Executive Board Assessment

Executive Directors noted Belarus's relatively strong macroeconomic performance in recent years, with rapid growth and declining inflation. While this performance reflected broadly prudent fiscal and monetary policies, and strong partner country growth, Directors stressed that growth through 2006 also owed much to favorable terms for imported energy.

Most Directors emphasized that the outlook going forward was likely to be less favorable, with energy costs rising following the new multi-year energy agreement with Russia and the resulting worsening terms of trade. These Directors stressed that the resulting permanent real income loss would adversely impact growth, inflation, the balance of payments, and the fiscal position, especially in the absence of commensurate policy adjustment and structural reform.

Against this backdrop, Directors welcomed the authorities' initial policy response to the terms-of-trade change, but cautioned that heavy reliance on foreign financing should not substitute for adjustment. They noted that the pass-through of higher energy import prices, the more moderate increase in wages, and—critically—the strong fiscal restraint in evidence to date had helped maintain macroeconomic stability. However, most Directors expressed concern about the incomplete pass-through of energy price increases, the continued rapid growth of credit, and the insistence on official targets that call for substantial fiscal and monetary loosening by year-end. These factors, together with the slow pace of structural reforms, would raise external financing needs, the bulk of which would be debt-creating, thereby escalating macroeconomic risks. Some other Directors, however, saw merit in the authorities' gradual approach to reform, stressing the importance of long-term social and economic stability.

Directors considered that the permanent terms-of-trade shift and the likely lag in the supply response called for early adjustment in the policy mix, including a tighter wage policy. In addition, they urged the authorities to implement market-oriented reforms that would substantially reduce state intervention in the economy.

Directors stressed the importance of tightening the fiscal stance. In particular, Directors encouraged the authorities to press ahead with their plans to limit expenditures and improve the operation of the tax system. Also, subsidies to public enterprises and banks should be reduced and the targeting of social spending should be improved.

Directors welcomed the clarifications in the monetary policy framework envisaged for 2008, but saw continued rapid credit growth as inconsistent with maintaining the

exchange rate peg. Directors welcomed the planned shift to a formal peg to the dollar, which would eliminate the divergence between the National Bank of the Republic of Belarus (NBRB)'s de jure and de facto exchange rate targets. They observed, however, that to maintain the peg, credit growth needed to be slowed, notably through a phase-out of directed lending. In addition, most Directors noted the deteriorating current account position and the erosion of the economy's competitiveness, as unit labor costs had risen substantially, export market shares in the CIS had decreased, and on the staff's calculations, the real exchange rate had appreciated significantly. Looking ahead, a number of Directors advised the authorities to consider creating the preconditions for greater exchange rate flexibility over time.

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 needed to remain vigilant in strictly enforcing prudential requirements. Directors welcomed recent steps toward attracting strategic foreign investors to the banking system, stressing the importance of transparent and competitive privatization procedures.

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.

Republic of Belarus: Selected Economic Indicators

	2003	2004	2005	2006 Preliminary
	(Annual change in percent, unless otherwise indicated)			
Real economy				
GDP (nominal; billions of rubels)	36565	49992	65067	79231
Real GDP	7.0	11.4	9.3	9.9
Industrial production	7.1	15.9	10.5	...
CPI (average)	28.4	18.1	10.3	7.0
Real average monthly wage (1996=100)	238.7	279.0	338.6	377.2
Average monthly wage (U.S. dollars)	116.3	129.1	156.8	175.7
Money and credit				
Reserve money	69.7	41.9	73.7	19.8
Rubel broad money	71.0	58.1	59.5	44.5
Banking system net domestic credit	68.9	39.1	34.8	51.9
Refinance rate (percent per annum, end-of-period)	28.0	11.0	11.0	10.0
	(Percent of GDP)			
General government finances 1/				
Revenue	45.9	46.0	47.4	48.5
Expenditure (cash)	47.7	46.0	48.0	48.0
Expenditure (commitment)	46.9	45.6	48.0	48.0
Balance (cash)	-1.7	0.0	-0.7	0.5
Balance (commitment)	-1.0	0.4	-0.6	0.5
	(Millions of U.S. dollars unless otherwise indicated)			
Balance of payments and external debt				
Current account balance	-424	-1206	469	-1512
As percent of GDP	-2.4	-5.2	1.6	-4.1
Gross international reserves	499	770	1297	1383
In months of future imports of goods and services	0.3	0.5	0.7	0.6
External debt (percent of GDP)	23.7	21.5	17.2	18.6
Short-term external debt (percent of GDP)	15.6	16.6	12.1	14.2
	(Rubels per U.S. dollar)			
Exchange rates				
Average	2052	2160	2159	2146
End-of-period	2156	2170	2152	2140

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

Statement by Mr. Willy Kiekens, Executive Director for the Republic of Belarus and Mr. Mikhail Nikitsenka, Advisor to the Executive Director
August 24, 2007

On behalf of the Belarus authorities, we thank the staff for the continued productive dialogue, and their helpful policy recommendations and technical assistance. The authorities welcome the increasing degree of convergence of views with the staff on the economic performance and medium term policies. Many of the policy recommendations of the staff have been reflected in the authorities' policy decisions, such as the recently adopted program for the development of the banking sector during 2006-2010.

General Remarks

Notwithstanding the recent deterioration of the external conditions, due to a doubling of the price of energy imported from Russia, the economy continues to grow briskly. Annualized GDP growth was 8.8 percent during January-July 2007. The authorities are satisfied with the staff's recognition of their efforts and achievements in maintaining steady economic growth through most of the transition period. Indeed, with 140 percent during 1990-2006, Belarus recorded the highest GDP growth among CIS countries. The average annual growth during the last three years exceeded 10 percent. The authorities share the assessment of the Fund that, to a certain extent, the high growth is explained by the favorable terms of trade which Belarus enjoyed until the recent drastic increase of the price of imported energy. Nevertheless, the authorities believe that the growth performance is largely explained by the stable macroeconomic environment, including prudent fiscal policies, a stability enhancing exchange rate policy, declining inflation and a strengthening of the financial system. The authorities also stress the importance of the country's favorable record in maintaining, during the last ten years, a high average investment ratio of 25 percent of GDP, which was the second highest in the CIS region.

Due to the financial constraints caused by this year's energy price hikes, the investment ratio dropped to a still high level of 20 percent during the first half of 2007. The constraints of internal financial resources have been compensated by more available external resources. The privatization receipts are estimated to increase to 1.5 percent of GDP in 2007.

To mitigate the impact of the higher imported energy prices on the current account the authorities have adopted and are successfully implementing a comprehensive energy savings program for the period until 2011. In the first half of 2007, the energy intensity of GDP has already dropped by 14 percent.

Belarus has the lowest public debt to GDP ratio among the transition countries. The authorities therefore consider it prudent to borrow limited amounts to smooth the adjustment of the economy and to finance the energy savings program. In this, Belarus follows the successful experience of other transition countries that used additional borrowing to finance growth-promoting programs.

Given the magnitude of deterioration in the terms of trade, the drop in enterprise profitability by 1.5 percentage points to 11.9 percent is seen as moderate. Most of the decline in profitability is concentrated in the oil processing industry, which recorded a decline in its profitability from 23.1 percent to 5.3 percent. At the same time, we would like to mention that the number of loss-making enterprises has dropped from 19.5 percent to 17.5 percent.

One of the main topics during the consultation discussions was the desirable level of the pass-through to users of the higher energy import prices. The staff concluded that the pass-through of the 114 percent rise in gas import prices was incomplete as tariffs rose by 20 percent for households and by up to 89 percent for enterprises. These new tariffs represent an average pass-through of about 60 percent. The staff is advocating an immediate full pass-through. However, the authorities consider a more gradual approach more consistent with long term social and economic stability.

Monetary Policy - Exchange Rate Policy and External Competitiveness - Financial Sector Policies

Moderate wage growth will be a key factor in preserving the competitiveness of the economy and in helping to offset the recent terms of trade losses. Thus, the average wage growth in 2007 will be much closer in line with labor productivity increases, as recommended by the staff. More modest wage increases will weaken consumer demand growth. As a result, notwithstanding the pressures caused by sharply rising energy prices and by the higher inflation in two main trade partners, i.e. Russia and Ukraine, consumer prices in Belarus rose by only 3.6 percent in the first half of 2007, slightly above last year's indicator of 3.1 percent.

The authorities are committed to further reducing inflation by pursuing prudent monetary policy. The de facto peg to the U.S. dollar served as a strong stabilizing factor. Along with tight monetary and fiscal policies, it helped to reduce annual inflation to a comparatively low level of 7 percent in 2006.

Money growth is slowing significantly. The amount of cash in circulation rose by 7.5 percent in the first half of the year, compared with 23.3 percent in the same period last year. The rubel money supply rose by 5 percent in the same period, down from 18.6 percent in the same period last year. As a result, core inflation was 0.6 percent in June 2007.

Pegging the rubel to the U.S. dollar resulted in a gradual devaluation of the rubel versus the Euro and the Russian ruble, which was instrumental in maintaining competitiveness of Belarus in relations with its main trade partners.

Addressing the concerns expressed during last year's Board meeting, the authorities made an effort to boost the level of international reserves by 70 percent during the first half of 2007 to reach $2.4 billion, after the sale of state enterprises to foreign investors.

The growth potential of the financial sector is promising. The authorities intensified efforts to attract foreign capital for the banking sector and to see reputable foreign banks becoming

strategic owners. The new banking code and adhering to best international prudential standards have triggered increased interest of foreign investors in the banking system. The participation of foreigners in the capital stock of domestic banks rose from 8 percent last year to 14.3 percent in June 2007. The recent sale of two medium-sized banks to foreign investors will contribute to stronger competition and improved business standards. Several other banks are preparing themselves for a significant participation in their capital by foreign investors. This year, most of the large banks in Belarus obtained substantial credit lines with foreign banks without using state guaranties. This shows the improved creditworthiness of Belarus as confirmed by the recent Standard & Poor's B+ rating for long-term foreign currency debt.

To stimulate the critically important SME growth, the authorities and the EBRD, with the support of IFC and bilateral donors, have started the process of creating a special bank for micro financing. The new institution will support the development of SMEs by providing credit and other financial services, particularly in regions outside the capital. The project is expected to have a high transition impact by demonstrating to local banks the viability of SME lending.

Fiscal Policy

The 0.5 percent of GDP fiscal surplus in 2006 and the 1.9 percent of GDP surplus in the period January-May 2007 confirm the tradition of prudent fiscal policies with high tax revenues, strong tax administration, and a disciplined expenditure management. As it is recognized in the Staff Report, in the first five months of 2007 the authorities have implemented stricter fiscal policies than budgeted.

To reduce expenditures in response to the higher cost of imported energy, in addition to the expenditure cuts already undertaken, the authorities are finalizing the reform of the social security system which will be implemented from January 1, 2008 onwards. The new system envisages drastic cuts in all kinds of subsidies, resulting in substantial savings for the budget. The authorities are also committed to make subsidies compliant with WTO rules.

Last year, the taxation of financial and nonfinancial enterprises has been harmonized. The reform of the tax system is ongoing, and aims at reducing the overall tax burden and further simplifying taxation, particularly for small businesses.

Structural Reforms

The authorities are stepping up their privatization program which includes the sale of the gas transportation network "Beltransgas" and several large manufacturing enterprises which will be offered for sale within the next 6 months.

During the last two years IFC has doubled its activities in supporting private business in Belarus, increasing its investments from $20 million in 2005 to $40 million.

To create a better business environment for SMEs, last March the authorities amended and further simplified the tax regulations for SMEs. The government plans to reduce, still this year, the number of profit taxes for businesses and the frequency of tax reporting. The

procedures and formalities for setting up and closing businesses, and for obtaining licenses are all in the process of being simplified.