

Macroeconomic Conditions and Peculiar Features of the Republic of Belarus Monetary Policy Implementation at Current Stage

The Republic of Belarus is a dynamic open economy. Over the past few years, the country has been ensuring high economic growth rates and has been dynamically increasing investments. At the same time, some current problems and macroeconomic risks in the economy pose challenges whose tackling will be facilitated by improving conditions for economic performance and by providing stimuli to the business initiative. In such circumstances monetary policy must be aimed at promoting economic growth, above all, by delivering stability of the national currency and ensuring monetary instruments' adequate response to the changes in the environment and internal macroeconomic conditions.

The process of economic transformation in the Republic of Belarus is heading in the same direction as in other economies in transition. Therefore, the main characteristics of its monetary policy and current tasks are, basically, much the same as monetary policy orientation in other countries which find themselves at different stages of the transformation period. At the same time, a number of peculiar features of the Belarusian economy and the specific character of certain approaches to the paradigm of social and economic development have determined the specific character of the transmission mechanism functioning and, accordingly, some aspects of monetary policy development and implementation.

On the whole, the Belarusian economy can be characterized as a small open economy. Under the geographical division of labor which emerged during the Soviet era, it specialized, above all, in the assembling and processing industries and functioned as part of a single complex. This determined the structure of the economy inherited by Belarus which is based on large enterprises currently dominating engineering, oil processing, petrochemical, and chemical industries.

Such structure of the economy, considering the existing technologies, makes it possible to ensure the competitiveness of domestic industries in a number of external markets. The country's major foreign trade partners are Russia, the Netherlands, Ukraine, Germany, Poland, and the UK.

The Russian Federation is the main trading partner in terms of both exports and imports. It should be noted that strong positions of the Belarusian goods in the Russian market made a significant positive impact on the economic growth rates in the Republic of Belarus. This was due to the fact that high growth rates of energy prices which have been observed over the past few years constituted a strong stimulus to the economic growth in the Russian Federation and resulted in an increase in the domestic demand in the Russian economy. This set preconditions for the expansion of Belarusian exports to Russia and, accordingly, became a significant factor behind the economic growth in our country.

GDP growth rates in 2005 – 2006 exceeded 109% a year, on average. During 2003-2005, capital investments into fixed capital grew by nearly 120% amounting to 131.5% in 2006. Beginning in 2001, the GDP volume in dollar terms grew more than 3.5 times, while capital investments into fixed capital more than 6 times.

¹ First Deputy Chairman of the Board, National Bank of the Republic of Belarus

Maintaining attained high rates of economic growth is the most important task because it is a prerequisite for the promotion of the Belarusian economy's competitiveness in the international arena and, in the long run, the improvement of the country's living standards.

It's worth mentioning that despite dynamic development of the Belarusian economy there are still some problems that have not been tackled, namely:

1. Heavy tax burden which curbs economic and investment activity of enterprises, private sector development, and the competitiveness of Belarusian goods in the domestic and external markets. In 2007, the income/GDP ratio was 50%;
2. High depreciation of the active part of fixed assets which has an adverse impact on the production competitiveness and efficiency;
3. Underdevelopment of small and medium-size business;
4. Restricted growth rates of the financial market;
5. Demographic trends towards the ageing of the population which will substantially increase, in the future, the load not only on the pension system but on health care as well;
6. The economy's vulnerability with respect to external influence owing to poor diversification of exports and imports, on the one hand, fuel and energy balance, high consumption of energy and materials, and dependence on the prices for imported fuel and energy, on the other;
7. Scarcity of investments to modernize fixed assets;
8. Inadequate innovative activities and lack of the mechanism to transfer new knowledge and technologies from abroad, including by means of the foreign investments attraction; and
9. Banking risks resulting, above all, from the financial standing of enterprises as well as administrative regulation.

As a result, these problems give rise to a number of tasks whose tackling is deemed necessary at the state level and is mandated by the Program of Socio-economic Development of the Republic of Belarus for 2006 – 2010. The entire government economic policy of the Republic of Belarus is aimed at the implementation of this Program, including monetary policy as its integral part.

The five-year Program identified the following priorities for the economic development:

- all-out harmonious development of man on the basis of raising real monetary incomes and qualitative improvements in education, health care, culture, physical training and sports, and housing as well as other service industries;
- innovative development of the national economy;
- augmentation of exports potential on the basis of enhancing the competitiveness of the national economy;
- development of the agro-industrial complex and social development of the rural area;
- conservation of energy and resources; and
- development of small and medium-size towns.

As a result of implementation of measures stipulated by the Program the output in 2010 will noticeably grow compared with 2005:

- GDP by 146–155%;
- industrial output by 143 – 151%;
- agricultural output by 134 – 145%;
- capital investments by 198 – 215%;
- production of consumer goods by 150 – 157%; and
- foreign trade in goods and services by 153 – 160%, including exports by 155 – 162% and imports by 151 – 158%.

GDP energy intensity is planned to fall by 26 – 30.4%. Housing provision funded from all sources is to increase by 151 – 164%.

Maintaining stability of the national monetary unit is deemed to be the most important monetary policy contribution to the attainment of high rates of economic growth. Importantly, during 2000–2005 negative economic trends of the 1990s caused by the budget imbalance and sizeable credit emission were reversed. The elimination of the exchange rate multiplicity in September 2000 made it possible to pursue more effective exchange rate policy. The implementation of the mechanism of monetary policy based, above all, on the use of the national currency exchange rate as a nominal anchor was conducive to curbing inflationary and devaluation processes as well as monetary stabilization. Where in 2001 inflation rate measured by the CPI growth amounted to 46.1%, in 2006 it was down to 6.6%. While in 2001 the nominal exchange rate of the Belarusian ruble against the US dollar devalued by 33.9%, 2006 saw its revaluation by 0.6%.

Slowing inflationary and devaluation processes to a sufficiently low level was the most important outcome of monetary policy implementation creating a favorable background for the attainment of high economic growth rates. At the same time, the Belarusian economy was facing in 2007 a number of new processes and factors, above all, in the economy's external sector which had a significant impact on monetary policy implementation and set a series of new tasks requiring the monetary authority to neutralize adverse effects.

Among such factors which brought about a change in the external conditions of the Belarusian economy performance are, first and foremost, the following:

- changes in the terms of Russian energy supplies, including a twofold increase in prices for natural gas;
- increasing volatility of the exchange rates of the main world currencies as well as the of the national currencies of the states - foreign trade partners of the Republic of Belarus;
- rising prices for cereal and oil crops in the global markets (mainly because of the decrease in crop yields) as well as for milk and dairy products owing to the falling volume of milk production, increasing demand for dairy products, and the removal of farm subsidies on milk production in the EU countries;
- the US sub-prime mortgage crisis which hit a number of markets, including that of Western Europe; and
- acceleration of inflationary processes in the neighboring countries connected, somehow, with the above factors.

Changing terms of Russian energy supplies is the most significant factor as regards the scope of impact on the economy of our country. Taking into consideration heavy dependence of domestic enterprises on Russian energy supplies which is conditioned, on the one hand, by insufficient diversification of energy imports and, on the other hand, by relatively high energy intensity of production as well as a large share of exports of refined products in total exports of the Republic of Belarus, this factor entailed a number of consequences, such as:

- growing production costs of enterprises which resulted in a greater strain on their financial standing as well as certain reduction in their investment opportunities;
- increasing price volumes of imports and corresponding deterioration of the country's balance of trade;
- growing inflationary and devaluation expectations which resulted in an increasing demand for foreign currency in the domestic foreign exchange market in the early 2007; and

- increasing inflationary pressure which manifested itself, above all, in the early 2007, in the acceleration of growth rates of the PPI for industrial products.

Other above-mentioned factors which emerged in the global markets also contributed to higher inflationary pressure in the Belarusian consumer's market. The national economy suffered from the shortage of liquidity in the global financial markets least of all. This was due to the fact that the volume of external borrowings by the Belarusian banking sector is not large because the banking sector's sustainability does not depend, in large measure, on the access to external resources.

Deteriorating macroeconomic conditions of monetary policy implementation and, above all, the external environment required a number of tactical measures. The priority task was to normalize the situation in the foreign exchange market which was attained thanks to the implementation of a number of arrangements. These included an increase in the refinance rate by one percentage point, a more significant growth of rates (up to 20%) on refinancing operations carried out by the National Bank, as well as an absolute maintenance of the Belarusian ruble exchange rate at the prescribed level. This made it possible to preserve the confidence of the households and enterprises in the national currency, to divert households' monetary funds from the foreign exchange market into deposits in Belarusian rubles, and to preserve the resource base of the banking sector.

Exchange rate policy – maintaining the exchange rate of the Belarusian ruble against the US dollar within the band set by the Republic of Belarus Monetary Policy Guidelines for 2007 – played an essential role in anti-inflationary policy over the entire year. As the Russian ruble is becoming increasingly stronger against the US dollar, the efficiency of the simultaneous use of two exchange rate targets – against the US dollar and the Russian ruble – significantly decreased. Because of this, the exchange rate of the Belarusian ruble against the US dollar as the main currency of the domestic foreign exchange market, households' foreign exchange savings, as well as foreign trade settlements, including the Russian Federation, was actually used as a priority exchange rate target. At the same time, the US dollar dynamics with respect to major global currencies was conducive to decreasing the real effective exchange rate of the national currency and, accordingly, maintaining price competitiveness of the Belarusian exports.

It is worth noting that anti-inflationary measures of monetary policy combined the impact of both exchange rate policy and interest rate policy which was aimed at ensuring a balance between money demand and supply in the economy. The dynamics of interest rates during the year made it possible to avoid additional shocks which could deteriorate the financial standing of enterprises in the non-financial sector of the economy as well as adversely affect the sustainability of the financial sector. Both the opportunity for credit support of enterprises and high growth rates of investments in fixed capital required to continue the economy's modernization with a view to ensuring its competitiveness were maintained. At the same time, interest rates facilitated continued growth of the ratio of the banking sector's resources and the scale of its operations to GDP.

Also, growth rates of the monetary aggregates substantially slowed with respect to the previous year which was one of the factors curbing inflation. For example, the active ruble money supply (M1) increased over the year by 24.4% (in 2006 M1 grew by 42%). The ruble money supply (M2) increased by 29.2% (in 2006 M2 grew by 44.5%).

At the same time, the totality of the above-mentioned adverse factors determined substantially higher, compared with the forecast, inflation rates. In the whole of 2007, the CPI grew by 12.1%, the forecast being 6 – 8%. However, sufficiently high rates of economic growth were maintained. GDP increased by 8.2% against the previous year which allows us to view, on the whole, the results of monetary and general economic policy implementation favorably.

The Republic of Belarus Monetary Policy Guidelines for 2008 are aimed at maintaining and consolidating positive trends in the economy. Preserving major approaches and principles that have proven to be positive, current monetary policy measures take into account the experience of neutralizing the impact of adverse environmental trends gained in 2007.

The monetary policy objective in 2008 is to protect and ensure the Belarusian ruble stability, including its purchasing power and the exchange rate against foreign currencies.

The main means to attain this objective will be maintaining the Belarusian ruble stability against the US dollar. The exchange rate is stipulated to fluctuate within the plus-minus 2.5% band with respect to the exchange rate as at the beginning of the current year, i.e. within the year the exchange rate will be approximately in the range of 2,100-2,200 Belarusian rubles versus the US dollar.

It is planned to continue to increase the role of the interest rate as a monetary instrument and enhance the efficiency of interest rate policy. In doing so, the principles of interest rate policy that proved to be positive in the past few years will be preserved, first of all, the maintenance of interest rates at the level which is conducive to the growth of savings in the national currency and the expansion of credit availability for economic agents.

The overall dynamics of interest rates will be defined by the refinance rate. Based on the assessment of key macroeconomic indicators, the projected inflation rate being 6-8%, a reduction in the annual refinance rate to 7 – 9% by the end of 2008 is deemed possible. By the end of 2008, interest rates on new term deposits and on bank loans to enterprises and households may amount to 7-10% and 10 – 12%, respectively.

With the demand for banking services from the non-financial sector of the economy and households growing, further enhancement of banking sector sustainability in 2008 will be a priority.

In building up banks' capital, it will be necessary to take into account the need for both ensuring their sustainability and maintaining investment attractiveness of the banking sector. Banks' capital is estimated to grow by 21% and return on capital to exceed 8%.

Enhancing efficiency and functional relevance of the banking sector will manifest itself in continued faster growth of banks' assets compared with GDP. For example, the banking sector's assets and the resource base of the banks are forecasted to grow by 37%, with the banks assets/GDP ratio increasing up to 47.8% by the end of 2008.

The volume of households' deposits with the banks is projected to increase over the year by 3.7 trillion Belarusian rubles. This forecast is based on the increase in the households' monetary incomes and the structure of prospective spending, the decrease in the inflation rate, and the expansion of the list of banking operations and services along with their quality improvement.

In addition, by the end of 2008 the legal persons' deposits with the banks will grow by 3.4 trillion Belarusian rubles. The major factors of their growth will be as follows:

- growing sales of products, goods, works, and services owing to the output growth and the reduction of the stock of finished goods in industry to the branch levels, the stock of commodities in trade, and construction in progress;
- growing monetary share in the total proceeds from the sale of products, goods, works, and services arising from the reduction in the share of non-monetary forms of settlements and unpaid proceeds;
- growing profitability stemming from the reduction of materials, energy, and labor intensity in the production of products, works, and services;

- reduction of loss-making organizations by means of enhancing their efficiency; and
- tax burden reduction.

Stipulated volumes of lending represent an increase in the scope of banks' participation in the development of the economy's real sector and the tackling of social problems. Bank loans will play an increasing role in GDP formation and national wealth growth. Banks' claims on the economy will increase by 41% amounting to 35.8% of GDP. Investment lending in 2008 is projected to amount to 5.7 trillion Belarusian rubles.

Banks will maintain high quality of their assets. The share of problem assets in the assets subject to credit risk will not exceed 4%, the share of clients' and banks' problem indebtedness on credit operations 2%.

At the same time, as experience of many economies in transition shows, the implementation of monetary measures alone cannot assure the success of anti-inflationary policy in the long run. The restructuring which provides internal stimuli for the growth of production and investments as well as promotes the growth of foreign direct investments is instrumental at the time of economic changes. The work to review legislation regulating the terms of economic activities started by the Government and the National Bank in 2007 is part of efforts to provide a more favorable economic environment.

This work is designed to drastically improve business climate in the country which will enable the Republic of Belarus to rank among 25 global economies with the most favorable business environment. It is well known that at present, according to the annual report "Doing business" by the World Bank and IFC, the Republic of Belarus ranks 110th among 178 countries covered by the survey. Of course, the methodological basis of this survey and the correctness of individual conclusions can be debated, however one cannot but agree that measures designed to substantially change business climate in the country are well-timed and necessary, and fully correspond to the general trend set forth in the Program of Social and Economic Development of the Republic of Belarus for 2006-2010.

Business climate in the Republic of Belarus is expected to be radically improved, above all, thanks to:

- substantial reduction of procedures and time required for incorporating a company, licensing, property registering, formalizing international transactions, and closing a company;
- gradual reduction in tax burden and streamlining the taxation system; and
- legislative and judicial protection of investors and the streamlining of contract implementation procedures.

Further transformation of ownership rights will be facilitated by:

- cancelling the institution of "Golden share" in the Republic of Belarus;
- phasing out limitations to the alienation of stocks (shares) in the authorized capital of commercial organizations established in the process of denationalization or privatization; and
- streamlining procedures for the making decisions regarding the disposal of state-owned property, including land.

Creation of relevant financial instruments, institutions, and mechanisms for their functioning would facilitate the formation of an efficient domestic financial market, above all, by means of:

- cutting taxation on corporate securities operations;
- listing and selling blocks of shares in Belarusian enterprises, including large enterprises;
- creating equal conditions of operation for private and state-owned insurance organizations; and

- creating efficient investment funds and other non-bank financial institutions.

Other areas of the investment climate improvement include:

- creating the most favorable conditions for foreign investors in small settlements, including in terms of tax reduction, administrative control, protection guarantees against adverse changes in legislation during five years, and the right to have foreign insurers insure their property interests;
- improving conditions for the establishment and operation of residents of free economic zones; and
- encouraging the development of innovative production, also with the participation of foreign investors, including a complex of organizational, fiscal, and other measures aimed at accelerating innovative activities.

A series of decrees and edicts of the President of the Republic of Belarus providing new stimuli for business and investment activities have already been adopted as part of these measures, other regulatory acts being in the process of preparation.

An improvement in business climate may prove to be, in our opinion, a significant factor in maintaining high rates of economic growth and attaining targets of social and economic development in Belarus. This will favorably affect the process of further strengthening of the country's banking sector and increasing its functional significance in the economy.

Maximal assistance for the processes of economic growth, above all, by ensuring internal and external stability of the national monetary unit is the task of monetary policy under these circumstances. To this end, the continuation of the evolutionary development of the hierarchy of monetary objectives and intermediate targets, the streamlining of the system of monetary policy instruments, the study of the transmission mechanism in the economy of the Republic of Belarus, and the development of the mathematical modeling of economic processes must be ensured.