

Chapter 1

Economic and financial situation of the Republic of Belarus

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1.1. Macroeconomic conditions of monetary policy implementation and banking sector development

Implementation of monetary policy and development of the banking sector are to a great extent dependent on the efficient functioning of all sectors of the economy and social sphere. The macroeconomic situation in 2008 was characterized by economic growth; a rise in households' real monetary income and employment, volumes of foreign trade, and investment in fixed capital; consolidated budget surplus; and higher inflation (Attachment 1.1).

It should be noted that beginning in September 2008 economic conditions were deteriorating every month. This was reflected, above all, in declining demand for the Belarusian goods in the external market due to the global financial and economic crisis. In 2008 Q4, product manufacturing and sales were slowing which had an adverse effect on the economic condition of some enterprises and foreign exchange market and brought about an increase in non-payments and finished-goods inventories of industrial organizations.

Gross domestic product (hereinafter—"GDP") amounted to 128.8 trillion Belarusian rubles, up by 10% on a year earlier in comparable prices, the forecast growth being 8-9%.

GDP energy consumption fell by 8.4%, the forecast being 7-8%.

GDP growth was enabled by the expansion of both domestic and external demand which was more intense in January-August 2008.

Retail turnover (in comparable prices) increased by 20.5% compared with 2007 (in 2007 by 15.3% from a year earlier), and paid services to households by 13.9% (in 2007 by 11.5% compared with 2006). Such increases were due to the growing consumer demand, which resulted from the rising real money income of and expanding bank lending to households. **Households' real wages and real money income** grew by 9.9% and 12.7% respectively.

Investment in fixed capital in 2008 (in comparable prices) increased by 23.1% on a year earlier (by 16.2% in 2007). The annual volume of investment in fixed capital reached 35.9 trillion Belarusian rubles, 27.9% of GDP (26.8% in 2007).

Like in 2007, most of capital investment came from industry, housing, and agriculture whose share in fixed capital investment accounted for 27.7%, 17.9%, and 14.6% respectively.

The main sources of financing were own resources of organizations, budgetary funds, and bank credit which accounted for 87.2% of total capital investment (85.7% in 2007).

Bank credit continued to grow faster than the main sources of capital investment.

According to the National Statistics Committee, the overall volume of used credit resources (in comparable prices) increased by 30.6% compared with 2007 (by 23.9% in 2007), including domestic banks' credit by 35.7% (by 23.9% in 2007).

In 2008, **industrial output** grew by 10.8% compared with 2007. Consumer goods production rose by 12.1%, including foodstuffs by 13.1% and non-foods by 11.6%. The highest rate of growth was registered in fuel industry (11.1%), machine-building, metal-working, and construction materials industries (10.2% in each), whilst light industry experienced the lowest pace (0.7%).

Agricultural output (in comparable prices) rose by 8.9% compared with 2007, including in agricultural organizations and peasant holdings (farm enterprises) by 14% and in household holdings by 0.7%.

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Transportation of cargo by common carrier organizations increased by 6.8% compared with 6.2% in 2007, with cargo turnover going up by 5.2% (by 5.5% in 2007) and passenger turnover going down by 10.6% (by 1.6% in 2007).

Financial situation of organizations was characterized by growing real volumes of sales and profit, increasing profitability of sold products and sales, and a shrinking number of loss-making enterprises.

Proceeds from the sale of organizations' products, goods, works, and services in current prices amounted to 271.5 trillion Belarusian rubles, up by 33%, with the average prices in the economy (the GDP deflator) rising by 20.5%. As a result of the adverse effect of the global financial and economic crisis, in December, compared with August, sales fell by 13.9%, net profit by 78.8%, profitability of sold products by 11.4 percentage points (to 6.6%), and return on sales by 4.6 percentage points (to 4%).

Financial indicators of organizations in different industries varied substantially. Since growth of the return on sold products (155.7%) was outstripping that of the production cost of the products sold (129.2%), the profitability of sold products, works, and services went up from 11.8% in 2007 to 14.2% in 2008, including in industry from 12.9% to 15.3%, in construction from 9.9% to 11.7%, in agriculture from 0.8% to 8.4%, trade and public catering from 17.1% to 20.8%, and in transportation from 15.9% to 16%. Profitability declined in electric power industry (by 1.8 percentage points), in ferrous metallurgy (by 1.5 percentage points), in machine-building and metal-working industries (by 2.2 percentage points), in food industry (by 4 percentage points), in forestry, wood-working, and pulp-and-paper industries (by 1.4 percentage points), in communications (by 2.4 percentage points), and in housing and utilities (by 0.6 percentage points).

Of the total number of organizations, those that incurred net loss accounted for 4.8% compared with 6.3% in 2007, while the share of loss-making organizations was 14.7% and 19.9% respectively.

Owing to the outstripping growth of funds on organizations' accounts (137.5%) compared with the growth of outstanding payables (123.1%), current paying capacity increased from 156.9% as at January 1, 2008 to 175.2% as at January 1, 2009. At the same time, current paying capacity of industry's organizations fell from 199.8% to 186%.

The number of the unemployed registered with state employment offices as at the end of December 2008 was 37.3 thousand, down by 6.8 thousand, or by 15.4%, compared with early 2008. Registered unemployment fell from 1% as at the end of December 2007 to 0.8% of the gainfully employed population. Involuntary part-time employment was 140.9 thousand, or 4% of the monthly average strength, compared with 3.4% in 2007.

The number of employed in the economy increased by 0.6% compared with 2007.

The **republican budget** received 49.05 trillion Belarusian rubles, or 105.7% of the annual plan approved by the Law of the Republic of Belarus "On the Republic of Belarus Budget for 2008", the **consolidated budget** 65.66 trillion Belarusian rubles, or 105.2% of the annual plan.

The overall level of centralization of financial resources in the budget (excluding the unpaid balances) increased from 49.6% in 2007 to 51%, with the unpaid balances-to-GDP ratio shrinking from 0.2% to 0.05%. The major factor contributing to growing centralization of financial resources was a substantial increase in tax proceeds from foreign economic activity.

Republican budget expenses in 2008 amounted to 48.13 trillion Belarusian rubles, or 37.4% of GDP and 96.7% of the annual plan, **consolidated budget expenses** 63.81 trillion Belarusian rubles, or 49.5% of GDP and 95.5% of the annual plan.

Expenditures relating to the social and cultural sphere and social policy had priority in implementing fiscal policy. 29.3 trillion Belarusian rubles, or 45.9% of consolidated budget expenses (in 2007, 24 trillion Belarusian rubles, or 50.4% respectively) was devoted to the social and cultural sphere (health care, physical culture, sports, culture and the mass media, education, social policy). In 2008, budgetary funds spending continued to be uneven across quarters (Attachment 1.2).

In 2008, the Government ran a **consolidated budget surplus** of 1.4% of GDP (1.85 trillion Belarusian rubles), compared with 0.4% in 2007 (0.42 trillion Belarusian rubles).

As at January 1, 2009, **the Government internal debt** was 8.58 trillion Belarusian rubles, increasing in 2008 by 2.45 trillion Belarusian rubles, or by 40% (Attachment 1.3). Its growth—1.9% of GDP—did not exceed the parameter stipulated in the Law of the Republic of Belarus "On the Republic of Belarus Budget for 2008" (3% of GDP).

In the structure of the Government internal debt, Government securities amounted, as at January 1, 2009, to 5.4 trillion Belarusian rubles (62.9% of the total volume). The volume of Government-

guaranteed credits reached, as at January 1, 2009, 2.65 trillion Belarusian rubles, increasing since early 2008 by 819.7 billion Belarusian rubles, while its share in the total amount of the Government internal debt accounted for 30.8%.

Government deposits in the accounts with the National Bank decreased in 2008 by 166.6 billion Belarusian rubles (by 2.9%), amounting, as at January 1, 2009, to 5.67 trillion Belarusian rubles, with the ruble-denominated deposits increasing by 1.34 trillion Belarusian rubles and amounting to 1.61 trillion Belarusian rubles and foreign exchange deposits decreasing by 1.5 trillion Belarusian rubles and amounting to 4.07 trillion Belarusian rubles (Attachment 1.4).

The consumer price index grew in 2008 by 13.3% (December on December), in 2007 by 12.1%, and in 2006 by 6.6% (Attachment 1.5).

The acceleration of inflationary processes was, above all, due to an increase in the production costs, caused by rising prices for imported raw and other materials, including energy, metals, and other intermediate products.

Increasing budgetary expenditures and bank credits to natural persons, as well as changes in the world food market in 2008 H1, also contributed to inflationary processes.

Core inflation (excluding the influence of changes in prices and tariffs for goods and services directly regulated by the Government and prices subject to seasonal movements) stood at 11.8% (10.2% in 2007).

The food price index increased, like in 2007, to 15.9%, with predominant growth of administratively regulated prices and prices whose dynamics depend on the situation in the external markets. For example, significant growth was registered in prices for wheat flour (by 33%), cereals and legumes (by 28%), macaroni products, milk and dairy produce (by 25.3%), as well as meat and meat products (by 19.7%), and bread and bakery products (by 18.1%).

In the year under review, the non-food price index grew by 6.8% (by 5.9% in 2007), the biggest increases being in the prices for medicine (by 16.5%), detergents (by 15%), writing utensils (by 13%), and construction materials (by 11%).

Market saturation as well as the fact that most of the producers of non-foods reached the ceiling of their price competitiveness with imports were, on the whole, responsible for slower rates of price growth therefor. However, as in the case of foodstuffs, the highest price growth among non-foods was observed in imported goods.

Tariffs for services in 2008 grew by 16.2% (by 10.5% in 2007), the most vigorous growth being in the tariffs for services offered by automobile commuter and international transport (by 27.6%), housing and utilities (by 27.5%), and sanatoriums and health-improving facilities (by 27.3%), which was, to a large extent, due to a rise in their production cost, as well as a higher level of cost recovery.

Industrial producers' prices rose by 14.2% compared with 16.8% in 2007, with prices for capital goods increasing by 10.6%, for intermediate goods by 14.5%, and for consumer goods by 15%.

1.2. Financial sector

Among Belarusian financial intermediation institutions (banks, non-bank financial, insurance, leasing and other organizations engaging in financial operations), banks are dominant in the financial services market.

1.2.1. Banking sector

1.2.1.1. Institutional characteristics

As at January 1, 2009, the banking sector comprised 31 bank. The number of branches fell from 365 to 323 owing to the streamlining by banks of their regional structures, closure of loss-making branches, and adoption of sophisticated management technologies.

There were eight representative offices of foreign banks, including those of the Russian Federation, Lithuania, Latvia, and Germany, as well as a representative office of the Interstate Bank in the Republic of Belarus.

Foreign capital participated in the authorized capital of 25 banks, eight of which were wholly-foreign owned.

In 2008, four banks were registered, with foreign capital prevailing in three of them—CJSC “Belarusian Bank for Small Business” (Great Britain, the Netherlands, the USA, and other investors), JSC “Zepster Bank” (Switzerland), and TC Bank (Iran).

Joint-Stock Company “DJEM-BANK” and “International Bank of Economic Cooperation”

Incorporated were in the process of bankruptcy or liquidation. Open Joint-Stock Company "BELORUSSKIY BIRZHEVOY BANK" and "InvestPromBank", Incorporated were liquidated and struck off the Uniform Register of Legal Persons and Independent Entrepreneurs.

Institutional development of the banks was characterized by:

- the increasing share of non-residents in the aggregate authorized capital of banks from 9.8% to 17%. The number of banks controlled by foreign capital increased from 16 to 20, with the share of these banks in the banking sector's assets increasing from 19.7% to 20.8% and in the aggregate regulatory capital from 16.9% to 21.5%. Capital from Russia, Cyprus, Austria, Ukraine, Great Britain, the Netherlands, Switzerland, Luxembourg, Kazakhstan, Latvia, Iran, Ireland, and other countries participates in the authorized capital of Belarusian banks;

- the reducing share of residents of non-state form of ownership in the aggregate authorized capital of the banking sector from 3.9% to 2.5%. The number of banks with the prevailing participation in the authorized capital of residents of non-state form of ownership remained at the 2007 level-6, whereas the share of these banks in the banking sector's assets declined from 3.7% to 1.5% and in the aggregate capital from 4.2% to 2.3%; and

- the declining share of Government agencies and state entities in the aggregate authorized capital of the banking sector by 5.7 percentage points (to 80.6%). The number of banks with prevailing participation in their authorized capital of Government agencies and state entities remained unchanged (5), their share in the banking sector's assets increasing from 76.5% to 77.7% and in the aggregate capital declining from 78.9% to 76.2%.

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1.2.1.2. Structure of banks' assets and liabilities

In the year under review, banks' assets and liabilities continued to grow, with their structure changing. Domestic growth sources continued to dominate the expansion of banks' liabilities, with foreign investment increasing. Banks started to accumulate free monetary funds more actively and lend them to the economy.

The average annual key macroeconomic indicators of the banking sector grew with respect to GDP:

- banks' liabilities (assets) from 35.2% to 39.7%;
- banks' claims on the economy from 25.8% to 29.1%;
- regulatory capital from 5.77% to 5.82%; and
- authorized capital from 4.01% to 4.03% (Attachment 1.6).

The banking sector's liabilities (including banks in the process of liquidation) grew by 21.37 trillion Belarusian rubles, or by 51.3% (by 43.8% in 2007), totaling 63.06 trillion Belarusian rubles as at January 1, 2009 (Attachment 1.7). The bulk of these (77.2%) belongs to JSC "JSSB Belarusbank", JSC "Belagroprombank", JSC "BPS-Bank", and "Belinvestbank" JSC (hereinafter-the "state-owned banks"), the state's share in their authorized capital exceeding 50%.

Banks' liabilities grew mainly due to residents' funds which accounted in 2008 for a 72.8% increase in banks' attracted funds and a 69.2% increase in liabilities as at January 1, 2009 (67.3% as at January 1, 2008).

Among residents, legal and natural persons' funds dominated banks' liabilities (41.6% as at January 1, 2009). In 2008, their share dropped by 6.7 percentage points, of which households' funds by 4.4 percentage points and legal persons' funds by 2.3 percentage points (Attachment 1.8).

As at January 1, 2009, funds of natural persons amounted to 13.27 trillion Belarusian rubles (21% of banks' liabilities), increasing in 2008 by 2.65 trillion Belarusian rubles (by 24.9%) and accounting for a 12.4% increase in the funds attracted by the banking sector. Growing inflationary and devaluation expectations in 2008 Q4 and changing preferences as to the currency of savings influenced the dynamics and structure of households' deposits which amounted to 99.9% of the funds attracted from natural persons. As a result, households' deposits grew by 2.69 trillion Belarusian rubles (by 25.5%), of which ruble deposits by 0.95 trillion Belarusian rubles (by 13.9%) and foreign exchange deposits by USD754.2 million (by 42.9%). Funds in the national currency prevailed in the structure of natural persons' deposits (58.3%). In the structure of natural persons' funds, the volume of certificates of deposit dropped by 80.5%.

As at January 1, 2009, state-owned banks accounted for 85.2% of natural persons' funds (87% as at January 1, 2008) deposited with the domestic banks. JSC "JSSB Belarusbank" which amassed 58.9% of natural persons' funds attracted by the banks of the country (60.6% as at the beginning of 2008), dominated the market of households' deposits.

The funds of legal persons grew by 3.43 trillion Belarusian rubles (by 36.1%), amounting to 12.95 trillion Belarusian rubles (20.5% in the structure of banks' liabilities and 16.1% in their growth).

The Government and local governments and self-administration authorities made the greatest contribution to the growth of the banking sector's liabilities in 2008, assuring a 33.2% increase in banks' liabilities. The share of their funds in the structure of banks' liabilities increased by 7.2 percentage points to 19.2%, with their amount increasing 2.4 times and totaling 12.08 trillion Belarusian rubles as at January 1, 2009. Such a considerable increase in the Government's and local governments' and self-administration authorities' funds was due to the financial support provided by the state to banks experiencing liquidity deficit.

Though banks were actively involved in attracting foreign investments, the growth of the banking sector's foreign liabilities ceased in 2008 H2 due to the worsening possibilities of acquiring credit resources in the international interbank market. Non-residents' funds grew less intensively in the year under review compared with 2007 (by 26.8% and 81% respectively), accounting only for a 6.7% growth of banks' liabilities. The share of non-residents' funds in the resources attracted by banks dropped by 2.1 percentage points, amounting to 10.7% as at January 1, 2009.

Banks' other liabilities increased by 52.8%, amounting to 20.5% in the growth of all funds attracted in 2008. The growth of this indicator was mainly due to the increase in the state share in the authorized capital of state-owned banks. The state investments in the authorized capital of these banks totaled 3.1 trillion Belarusian rubles.

In the banking sector as a whole, funds in the national currency prevailed in banks' liabilities. As at January 1, 2009, the share of funds in Belarusian rubles amounted to 70.2% (63.5% as at the beginning of 2008), in state-owned banks 78.5% and 71.7% respectively. The funds in foreign exchange prevailed in the attracted funds of private banks (57.9%), shrinking in 2008 by 4.5 percentage points.

Bank's assets/GDP ratio grew at the end of 2008 to 49% versus 42.9% as at the beginning of the year.

Banks' funds were mainly used for lending to legal and natural persons (Attachments 1.9 and 1.10). Banks' claims on this category of borrowers accounted for 77.4% of the increase in the banking sector's asset operations in 2008. As at January 1, 2009, the share of this indicator amounted to 74.5% of assets, increasing in the year under review by 1.5 percentage points. In the funds placed by banks the share of credits to the economy grew by 1.5 percentage points (to 71%).

Banks' claims on the economy grew by 16.61 trillion Belarusian rubles (by 54.5%), amounting to 47.11 trillion Belarusian rubles as at January 1, 2009, with the parameter prescribed in the Guidelines being 36-41%. In the national currency they increased by 13.26 trillion Belarusian rubles (by 70.9%) totaling 31.96 trillion Belarusian rubles and in foreign exchange by USD1.4 billion (by 25.5%) totaling USD6.89 billion respectively (Attachment 1.11). The increase in banks' claims on the economy in the national and foreign currencies in real terms averaged in 2008 versus 2007 24.6% (27% in Belarusian rubles), with real GDP growing by 10%. As at January 1, 2009, the ratio of banks' claims on the economy to GDP increased to 36.6% versus 31.4% as at the beginning of 2008.

In the year under review, bank credit amounts owed by the economy's sectors increased by 15.79 trillion Belarusian rubles (by 54.5%), totaling 44.77 trillion Belarusian rubles as at January 1, 2009, including in the national currency by 12.86 trillion Belarusian rubles (by 71.2%) totaling 30.93 trillion Belarusian rubles and in foreign exchange by USD1.21 billion (by 23.9%) totaling USD6.29 billion respectively. As at January 1, 2009, credits in Belarusian rubles prevailed in credits granted by banks (69.1% versus 62.4% as at the beginning of 2008). The ratio of banks' credits to the economy as at January 1, 2009 to GDP grew from 29.8% to 34.8%.

Long-term credits were prevailing in the structure of banks' credit investments (72.8%), of which credits in the national currency accounted for 70.1%.

As at January 1, 2009, claims on legal persons prevailed in the funds placed by banks (54.3% versus 53.6% as at the beginning of 2008). The share of the above-mentioned claims accounted for 55.7% of the growth of the placed funds. Claims on legal persons grew in 2008 by 11.9 trillion Belarusian rubles (by 53.3%), totaling 34.23 trillion Belarusian rubles. Their major share (65.4%) was in Belarusian rubles.

In 2008, banks granted credits in the national and foreign currencies in the amount of 67.14 trillion Belarusian rubles, up by 21.33 trillion Belarusian rubles (by 46.6%) on 2007. Long-term credits amounted to 19.72 trillion Belarusian rubles, up by 0.92 trillion Belarusian rubles (by 4.9%) on 2007. Among legal persons, the most vigorous lending was observed in the agricultural sector (up by 60.3% on 2007), construction (up by 57.7%), industry (up by 40.3%), and trade and catering (up by 38.7%).

In 2008, according to the capital construction data compiled by the National Statistics Committee, credit resources worth 7.5 trillion Belarusian rubles (20.8% of the total capital investment versus 20.1% in 2007) were invested in fixed capital. The volume of credits granted by domestic banks reached 7.3 trillion Belarusian rubles (20.2% of the total capital investment versus 18.3% in 2007), while foreign banks' credits amounted to 0.2 trillion Belarusian rubles (0.6% and 1.8% respectively), with the demand for investment lending stipulated in the Guidelines being 5.2-5.7 trillion Belarusian rubles. Credits utilized in housing accounted for 39% of the total investment credit (38.1% in 2007).

Banks were actively involved in the provision of credit support to the institutions in the course of implementation of individual state programs and measures. Banks granted loans in the amount of 11.5 trillion Belarusian rubles (up by 88.7% on 2007) for the purposes stipulated in the state programs.

Banks allocated significant funds for lending to natural persons. As at the beginning of 2009, claims on households amounted to 12.72 trillion Belarusian rubles, up by 4.64 trillion Belarusian rubles (by 57.5%), accounting for 21.7% of the growth and 20.2% of the structure of banks' assets.

The market of banks' consumer lending continued to develop. As at January 1, 2009, natural persons' indebtedness under such credits stood at 5.75 trillion Belarusian rubles, increasing in 2008 by 65.5%.

As at the beginning of 2009, natural persons' indebtedness under credits to finance construction and purchase housing amounted to 6.7 trillion Belarusian rubles (including under soft credits 4.69 trillion Belarusian rubles). Interest rates were compensated out of budgetary funds.

1.2.1.3. Effectiveness and sustainability of the banking sector

The main qualitative characteristics of the performance of the banking sector testify to its sustainable development.

As at January 1, 2009, banks' regulatory capital amounted to 11.31 trillion Belarusian rubles, increasing in the year under review by 73.3% (the Guidelines forecast being 17-21%). The increase in the banking sector's aggregate authorized capital to 8.68 trillion Belarusian rubles (by 91.9%) was one of the principal sources of regulatory capital growth in 2008.

Banks' profit totaled 729.8 billion Belarusian rubles, a 1.2 times increase compared with 2007. The key factor of profit growth was an increase in the volume of asset operations.

At the end of 2008, the banking sector's profitability was as follows:

- return on assets 1.4% (down by 0.3 percentage points on 2007); and
- return on regulatory capital 9.6% (the Guidelines forecast being at least 8%), down by 1.1 percentage points on 2007.

Two key factors contributed to the profitability decline in November-December 2008:

- a significant increase in the banking sector's capital and assets, including due to the growth of the state's contributions to the authorized capital of the state-owned banks; and
- a decision on the need for the mandatory provisioning for potential losses on the assets exposed to credit risk (assets classified under Risk Group I) which considerably worsened financial results.

In 2008, two banks—CJSC "Belarusian Bank for Small Business" and TC Bank—were in the red.

As at January 1, 2009, banks' secure functioning was characterized by:

- adequacy of banks' regulatory capital (the ratio of own funds (capital) to the total amount of risk-weighted assets and off-balance sheet liabilities) was 21.8%, the prescribed minimum prudential requirement being 8%;
- ratio of liquid assets to total assets 23.2% (the prescribed requirement being at least 20%), up by 0.6 percentage points from 2007;
- short-term liquidity (the ratio of actual liquidity to required liquidity) 2.3 (the requirement being at least 1), up by 0.3 on 2007;
- instant liquidity (the ratio of assets on demand to liabilities on demand) 108.8% (the requirement being at least 20%), up by 4.8 percentage points on 2007; and
- current liquidity (the ratio of current assets to current liabilities) 102% (the requirement being at least 70%), up by 3.2 percentage points on 2007.

The National Bank exercised systemic monitoring of and control over the quality of banks' assets and credit amounts owed to banks.

The National Bank's Banking System Sustainability Committee was reviewing the state of credit portfolios on a quarterly basis.

Comprehensive inspections focused on banks' activities aimed at assuring liquid functioning and maintenance of an adequate level of credit risk.

At the same time, banks, in conjunction with law enforcement authorities and Government agencies, were taking measures needed for the repayment of bad debts, keeping them within the prescribed limits, and preventing their emergence.

In 2008, the share of bad (extended and overdue) debts in credit amounts owed by clients' and banks' indebtedness under credits and other asset operations dropped by 0.1 percentage points to 0.6%, 1.4 percentage points below the parameter prescribed in the Guidelines (not more than 2%).

In 2008, assets exposed to credit risk grew by 53.7% (by 47.5% in 2007) and bad assets (assets classified under Risk Groups III, IV, and V) by 34.5% (by 0.2% in 2007). The share of banks' bad assets in the assets exposed to credit risk fell from 1.92% to 1.68%, with the parameter prescribed in the Guidelines being not more than 4%.

In 2008, credit amounts owed by legal persons (excluding banks), credits granted to natural persons, and funds deposited with banks prevailed in the assets exposed to credit risk.

1.2.2. Financial markets

1.2.2.1. Foreign exchange market

Situation in the domestic foreign exchange market was determined by the state of the balance of payments.

Domestic foreign exchange market turnover increased by 88.9% compared with 2007, amounting to USD100.3 billion, including the over-the-counter market turnover by 109.6% (USD68.1 billion), and the stock market turnover by 74.1% (USD18.7 billion). A considerable increase in the foreign exchange market capacity was due to growing operations of resident legal persons, households, and banks—with an insignificant growth of non-residents' operations (Attachment 1.12).

Foreign exchange supply by resident legal persons jumped by 30.5% totaling USD19.5 billion and demand by 57.6% and USD23.4 billion respectively. As a result of foreign exchange purchase outpacing sale due to a growing foreign trade deficit, net foreign exchange purchase by resident legal persons totaled USD3.8 billion versus net sale in the amount of USD0.1 billion in 2007.

Households' supply of and demand for foreign exchange increased by 41.6% and 41%, totaling USD6.9 billion and USD7.5 billion respectively. Thus, households' net demand for foreign exchange in 2008 totaled USD0.6 billion versus USD0.4 billion in 2007. Households' net demand for foreign exchange grew, above all, due to its significant increase at the end of 2008 as a result of the devaluation expectations growth and partial conversion of savings into foreign exchange.

Non-residents' operations in the domestic foreign exchange market were characterized by growing supply by 7.7% (to USD2.4 billion), with demand declining by 2.3% (to USD2.5 billion). Non-residents' net demand for foreign exchange fell eight times—from USD262.6 million to USD31.9 million—due to the declining usage of Belarusian rubles in foreign trade operations and conversion of the balances of Belarusian rubles on non-residents' accounts into freely convertible currency (hereinafter—"FCC").

In 2008, resident banks sold, on a net basis, foreign exchange worth USD155.1 million versus USD224 million in 2007.

The US dollar accounted for the bulk of foreign exchange market operations—58.2%. However, its share fell by 9.9 percentage points compared with 2007, with the share of the euro increasing from 13.4% to 26.4%. The share of the Russian ruble in the foreign exchange market of the Republic of Belarus fell from 18% to 15%.

The volumes of operations involving other currencies remained insignificant—0.4%, decreasing by 0.2 percentage points compared with 2007.

1.2.2.2. Interbank credit market

In 2008, interbank credits in the national currency continued to be one of the main instruments regulating banks' liquidity. 30 resident banks as well as non-resident banks participated in this segment of the money market. The National Bank was exerting a corrective impact on it.

As at January 1, 2009, interbank credits (excluding repo transactions) accounted for 2.8% of the total ruble-denominated assets and 3.8% of banks' total liabilities in Belarusian rubles (2.7% and 3.4% respectively as at January 1, 2008). The interbank ruble credit market (hereinafter—the "IRCM") did not undergo major changes in 2008: overnight interbank credits accounted for over 80%;

transactions volume amounted to 39.4 trillion Belarusian rubles (37.6 trillion Belarusian rubles in 2007).

In 2008, development of the secured segment of the interbank ruble market continued—banks were attracting/placing resources by means of repo transactions. The average daily balance of debt under repo transactions amounted to around 287 billion Belarusian rubles (95.1 billion Belarusian rubles in 2007; 37.1 billion Belarusian rubles in 2006).

In 2008, the share of transactions with non-resident banks in the IRCM was insignificant and amounted to 1% (0.7% in 2007).

In 2008 Q1-Q3, IRCM developments were influenced by the banking system's excess liquidity. Its withdrawal by the National Bank made it possible to maintain the interest rate on the overnight interbank ruble credit at the level close to the refinance rate.

In 2008 Q4, the situation in the IRCM reflected the influence of unfavorable external economic factors and was developing under the impact of a significant liquidity deficit. The National Bank took steps to tighten monetary policy. The interest rate on overnight interbank ruble credit (which is the operational target of the National Bank's interest rate policy) was maintained at the level close to the ceiling set by the standing facilities designed to support liquidity.

On the whole, the interest rate on this credit was within the band set by the interest rates on standing facilities (overnight credit, swap operations, and deposits). Within the band, the interest rates level was smoothed by the National Bank's auction operations designed to regulate liquidity (Attachment 1.13).

1.2.2.3. Government securities market

In 2008, Government short- and long-term bonds (hereinafter—"GKOs" and "GDOs" respectively) in the national currency worth actually 3.19 trillion Belarusian rubles were placed in the primary market, up by 49.8% on a year ago (Attachment 1.14). GKOs and GDOs worth 1.45 trillion Belarusian rubles were retired at actual cost. As a result, the volume of GKOs and GDOs in circulation, as at January 1, 2009, grew by 1.75 trillion Belarusian rubles (by 45.7%) compared with early 2008, including GKOs by 0.19 trillion Belarusian rubles and GDOs by 5.39 trillion Belarusian rubles, and amounted to 5.58 trillion Belarusian rubles at face value. Government securities denominated in foreign exchange were not placed.

In 2008, the difference between the amounts of actually attracted and actually repaid Government securities was 1.74 trillion Belarusian rubles. Banks' claims on the Government denominated in securities increased by 1.84 trillion Belarusian rubles at book value (by 73.3%) and stood at 4.36 trillion Belarusian rubles as at January 1, 2009.

The average yield of the primary market of Government bonds (excluding issues placed by the Ministry of Finance by means of direct sale) denominated in Belarusian rubles amounted to 10.3% per annum, down by 0.5 percentage points on a year ago.

It is worthwhile noting that the average maturity of securities denominated in Belarusian rubles placed in the primary market of Government bonds increased due to GDOs' dominance over GKOs which is a positive signal for investors. In 2008, it was 454 days (414 days in 2007).

The total volume of Government securities traded in the secondary market on the floor of Joint Stock Company "Belarusian Currency and Stock Exchange" (excluding issues placed by the Ministry of Finance by means of direct sale) amounted to 17.02 trillion Belarusian rubles. More than twofold excess over the 2007 level was mainly due to higher business activity in the year under review (Attachment 1.15).

Nearly 10.3 thousand deals were concluded at the stock exchange (7.67 thousand in 2007).

The weighted average yield on outright transactions stood at 10.3% per annum (10.6% per annum in 2007), of which involving GKOs 10.4% per annum, involving interest-bearing GDOs 10.3% per annum, and involving discount GDOs 10.1% per annum.

The weighted average repo rate involving GKOs stood at 11% per annum, involving interest-bearing GDOs 12.5% per annum, and involving discount GDOs 12.3% per annum.

As at January 1, 2009, 26 banks and 12 non-bank professional participants of the securities market were authorized to take part in the secondary trading in Government securities. Five issues of discount GKOs, 74 issues of interest-bearing GDOs, and 20 issues of discount GDOs were listed by Joint Stock Company "Belarusian Currency and Stock Exchange".

1.2.2.4. Corporate securities

In the year under review banks continued to issue securities. The National Bank approved 62 issues of banks' bonds worth 1,502 billion Belarusian rubles, EUR28 million, and USD126 million, of which:

- bonds secured by the obligations to repay the principal amount and to pay interest on the credits provided by them for construction, renovation, or purchase of housing against real property—13 issues, the volume of issue being 297 billion Belarusian rubles; and

- bonds issued under sub-paragraph 1.8 of paragraph 1 of Edict of the President of the Republic of Belarus No. 277 “On Certain Issues of Securities Market Regulation” dated April 28, 2006 (National Register of Legal Acts of the Republic of Belarus, 2006, No. 71, 1/7529), whose volume of issue may not exceed 80% of a bank's regulatory capital—49 issues worth 1,205 billion Belarusian rubles, EUR28 million, and USD126 million.

State-owned banks carried out open sale of bonds of their own issue to natural persons. The volume of the resources attracted by banks from the proceeds of the sale of bonds to the natural persons increased by 46.3% compared with 2007. Overall, 127.6 billion Belarusian rubles were attracted by banks through the placement of bonds (in the ruble equivalent) which were used to provide credits for housing and finance long-term investment projects.

In the year under review, banks issued shares worth 3.89 trillion Belarusian rubles (799.7 billion Belarusian rubles in 2007), of which open joint-stock companies 3.68 trillion Belarusian rubles (738.1 billion Belarusian rubles in 2007) and closed joint-stock companies 214.6 billion Belarusian rubles (61.6 billion Belarusian rubles in 2007). Banks carried out 27 issues of shares (21 in 2007)—11 issues by open joint-stock companies (12 in 2007) and 16 by closed joint-stock companies (9 in 2007).

The volume of issue of joint-stock companies' shares totaled 14.7 trillion Belarusian rubles (3 trillion Belarusian rubles in 2007). As at January 1, 2009, the value of shares in circulation amounted to 31.2 trillion Belarusian rubles (16.75 trillion Belarusian rubles as at January 1, 2008) (Attachment 1.16).

Resolution of the Council of Ministers of the Republic of Belarus and the National Bank of the Republic of Belarus No. 78/1 “On the Program of the Development of the Corporate Securities Market of the Republic of Belarus for 2008-2010” dated January 21, 2008 (National Register of Legal Acts of the Republic of Belarus, 2008, No. 27, 5/26665) contributed, in large measure, to the development of the corporate securities market in 2008 and the attraction of foreign capital thereto. The Resolution lifted restrictions on the alienation of joint-stock companies' shares, simplified procedures for corporate securities listing in the stock market, and eased tax burden on securities issue and placement which facilitated, on the whole, the privatization of state-owned organizations.

1.3. The balance of payments and gross external debt

In 2008, the compilation of the balance of payments was uneven. Favorable situation in the first half of 2008 was followed by a sharp decline in external demand and changes in the conditions of foreign trade in 2008 Q4 which resulted in a steady decline in the physical volumes of exports and the worsening of foreign trade balance. Besides, the global economic and financial crisis had a negative effect on external financing and capital inflow of the financial account of the balance of payments.

The balance of the current account of the balance of payments was negative in the amount of USD5 billion (minus USD3 billion in 2007). USD3.9 billion was attracted to the economy on a net basis under capital and financial operations, a 26.1% decline (by USD5.3 billion) on 2007. As a result, taking account of statistical discrepancies, the balance of payments was negative in the amount of USD1 billion (Attachments 1.17 and 1.18). The dynamics of export/import transactions in goods and services adversely affected the overall balance and current account.

The balance of foreign trade in goods was negative in the amount of USD6.1 billion, or 150.1% of the 2007 level, a 96.9% growth of the negative balance (around USD2 billion) coming from transactions in non-energy goods. The balance of foreign trade in energy remained virtually unchanged compared with 2007 and amounted to minus USD1.8 billion.

Goods exports amounted to USD33 billion, a USD8.7 billion (35.8%) increase compared with 2007. The physical volume of exports grew by 1.7%, with the average prices increasing by 33.3%. Energy exports amounted to USD12.1 billion, up by 46.3% on 2007. The physical volumes of energy exports grew in 2008 by 2.5%, accounting for a 5.4% growth in terms of value, while the increase in prices which totaled 142.7% accounted for a 94.6% growth in energy exports.

Non-energy exports amounted to USD20.9 billion (130.4% of the 2007 level). Their physical

volume grew by 0.6%. Where in 2008 H1 the growth of the physical volume of non-energy exports was 110.7% compared with the same period of 2007, in 2008 Q3 it dropped to 102.5%, and in 2008 Q4 to 78.4% due to a drastic decline in external demand related to the widening of the global financial and economic crisis.

Exports of goods to the Russian Federation rose by 19.1%, to other CIS countries by 64.2%, and to the non-CIS countries by 42%, the average dollar prices growing by 16.1%, 25.3%, and 47.7% respectively.

Imports of goods totaled USD39.2 billion, a rise of USD10.7 billion (by 37.9%) over the previous year. Their physical volume increased by 14.6%; the average prices by 20.1%. The growth of energy purchases amounted to 36.5% of the total imports growth, of intermediate non-energy goods to 40%, of investment goods to 9.6%, and of consumer goods to 13.9%. The physical volumes of energy imports grew by 9.4% (24.1% of growth of energy imports), the average prices for imported energy grew by 27.1%, contributing to the creation of a benign environment for trade in energy (112.3%).

Imports of non-energy goods amounted to USD25.3 billion (137.2% of the 2007 level). Their physical volume grew by 17%. At the end of 2008, the rates of imports growth in natural values dropped (109.5% in Q4), with the biggest fall being in intermediate and investment goods while imports of consumer goods were increasing. Where in January-September 2008 the growth of the physical volumes of consumer goods imports amounted to 108.4% compared with the same period of 2007, in the period under review it was 110.9%. At the same time imports of intermediate and investment goods decreased by 5.1 and 3 percentage points respectively.

The conditions of foreign trade measured as the ratio of indices of exports and imports prices to the level of the corresponding period of the previous year were, on the whole, favorable (111% including energy; 110.5% excluding energy). Positive results were obtained due to the situation in 2008 H1. However, faster decline in exports prices vis-a-vis import prices in 2008 Q4 brought about a gradual deterioration in the trade conditions.

The positive balance on services amounted to USD1.7 billion, increasing by 32.9% compared with 2007 due to the outpacing growth of the volume of services provided to non-residents—export and import of services increased by 29.9% and 28.1% respectively. The balance on services compensated 27.2% of the trade balance deficit (30.7% in 2007). The highest export growth rates were observed in financial (by 251.6%) and computer and information (by 165.6%) services. However, the rates of growth of transport services imports which amounted to 70.2% in the volume of exports and 49.7% in the volume of imports, exceeded the export growth rates (142.8% and 127.3% respectively).

The balance on factor incomes was negative in the amount of USD0.8 billion, exceeding by 94.6% the 2007 deficit level. The net receipts from labor incomes amounted to USD163.8 million, net payments under investment operations minus USD953.2 million (in 2007, USD151.6 billion and minus USD557.3 billion respectively). A considerable increase in accruals to direct investors (from USD434.8 million to USD682.1 million) as well as an increase in interest accruals on other types of investments (from USD237.4 million to USD488.1 million) caused an increase in the outflow of resources under the operations related to the payments for investments.

The balance of current transfers (free-of-charge receipts, including natural persons' monetary transfers) was positive in the amount of USD192 million (a 0.8% increase on 2007). USD422 million arrived to the country (up by 20.5% on a year ago), with current transfers to non-residents rising by 44% (to USD230 million).

The current account deficit was financed at the expense of capital and financial resources inflow which amounted to USD3,939.8 million (down by 26.1% on a year ago).

Capital account (capital transfers and purchase/sale of non-produced non-financial assets) was positive, ensuring capital inflow of USD143.2 million, a 55.3% increase on 2007. Capital inflow under this item was mainly due to imports of monetary funds and property by migrants entering the Republic of Belarus.

Capital inflow of the financial account of the balance of payments dropped by USD1.4 billion (by 27.6%) due to the reduction of other investments (commercial credits, credits and loans, funds in accounts and deposits, cash, etc.) by USD1.9 billion (by 53.1%), with direct investments increasing by USD0.4 billion (by 21.1%). The proceeds from the sale of the shares of Open Joint-Stock Company "Beltransgas" and Closed Joint-Stock Company "Belarusian Telecommunications Network" accounted for more than 40% of the attracted capital.

Commercial (trade) credits amounted in 2008 to minus USD49.6 million versus net attraction of USD690.2 million in 2007. Credits and loans dropped by almost USD1.5 billion (by 41.1%).

The final balance of payments was negative in the amount of USD1,002.8 million, resulting in the reduction of gross reserve assets against early 2008.

As at January 1, 2009, the volume of the economy's debt grew by 18.6% compared with early 2008 and amounted to USD14.8 billion, or 24.6% of GDP (Attachment 1.19). The share of the short-term debt in gross external debt dropped to 53.6%, compared with 62.9% as at January 1, 2008, owing to the attraction of a number of long-term credits.

External debt of the non-financial sector of the economy amounted to USD7 billion, increasing in 2008 by 3.5%. The structure of the enterprises' external debt changed insignificantly: the share of short-term debt amounted to 77.2% against 81.3% as at January 1, 2008. The share of this sector in gross external debt dropped from 54.3% to 47.4%.

Banks' external debt grew by 19.8% reaching USD3,081.1 million, with the long-term external debt and its share in banks' foreign liabilities showing the quickest growth (from 42.3% in 2007 to 51.9% in 2008). The share of the banking sector in the gross external debt grew by 0.2 percentage points, amounting to 20.8%.

The share of the Government debt (excluding enterprises' foreign loans provided against Government guarantees) amounted to USD3,588.8 million, exceeding 1.8 times the 2007 level. Practically all foreign investments were attracted in the form of long-term credit. The share of the Government debt in the total external debt increased 1.5 times, amounting to 24.2% as at January 1, 2009.

In 2008, the external debt of the monetary authorities fell from USD596.2 billion to USD429.9 million (2.9% of the gross external debt).

The negative international investment position of the Republic of Belarus (foreign assets less liabilities) increased by USD5.1 billion and amounted to USD13 billion as at January 1, 2009 (USD7.9 billion as at January 1, 2008).