COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 12.5.2003
COM(2003) 249 final

REPORT FROM THE COMMISSION

to the budgetary authority on guarantees covered by the general budget - situation at 30 June 2002

[SEC(2003)529]

TABLE OF CONTENTS

Part One:
Events Since The Report At 31 December 2001, The Risk Situation And Activation Of Budget Guarantees[1]

1. INTRODUCTION: TYPES OF OPERATION

The risks covered by the Community budget derive from a variety of lending and guarantee operations which can be divided into two categories: loans with macroeconomic objectives and loans with microeconomic objectives.

1.1. Operations with macroeconomic objectives

The first of these are the balance-of-payments loans for Member States or non-member countries, normally carrying strict economic conditions and undertakings.

1.2. Operations with microeconomic objectives

These are loans to finance projects which are usually repaid over the long term from funds which these projects are expected to generate; as a rule, they are granted to companies, financial institutions or non-member countries and, in addition to the Community guarantee, are covered by the usual guarantees demanded by banks.

This covers Euratom and NCI[2] loans in Member States and the Euratom and EIB loans outside the Community (Mediterranean countries, Central and Eastern Europe, countries of Asia and Latin America, Republic of South Africa).

2. EVENTS SINCE THE REPORT AT 31 DECEMBER 2001

2.1. Ukraine

On 17 January 2002, the Commission approved a proposal for a Council Decision providing macro-financial assistance to Ukraine. The amount to be granted is € 110 million in the form of a loan with a maximum maturity of fifteen years.

2.2. Federal Republic of Yugoslavia

The Commission is expected to approve a proposal for a Council Decision in the second half of 2002 providing macro-financial assistance to the Federal Republic of Yugoslavia. The amount to be granted is € 55 million in the form of a loan with a maximum maturity of fifteen years and € 75 million in the form of non-repayable grants.

---

[1] Please note that a Commission Staff working Paper contains a set of detailed tables and explicatory notes to this report [SEC(2003)529]

[2] Not active since 1995

2.3. Bosnia and Herzegovina

The Commission is expected to approve a proposal for a Council Decision in the second half of 2002 providing macro-financial assistance to Bosnia and Herzegovina. The amount to be granted is € 20 million in the form of a loan with a maximum maturity of fifteen years and € 40 million in the form of non-repayable grants.

3. RISK SITUATION

There are two possible methods for evaluating the risks borne by the Community budget:

– The method, often used by bankers, of the total amount of capital outstanding for the operations concerned on a given date (situation described in Annex 1 Table A1);

– The more budgetary approach of calculating the maximum amount which the Community could have to pay out in each financial year.

The second approach itself has been applied in two different ways:

– By reference only to actual disbursements at the date of the report, assuming that there are no early repayments (see Annex 1 Table A2 below showing the lower limit of this maximum risk to the Community budget);

– On a more forward-looking basis, by reference to all the operations decided by the Council or proposed by the Commission in order to estimate the impact on future budgets, assuming that the Commission's proposals are accepted (see Annex 1 Table A3 below showing the upper limit of this maximum risk borne by the Community budget).

The latter exercise gives some idea of the future level of risks connected with the proposals made. However, a number of assumptions have to be made about dates of disbursement and terms of repayment (details are given in the annex) as well as interest[3] and exchange rates[4].

The results are shown in Annex Tables A1 to A3, which make separate assessments of the risks relating to countries inside the Community and countries outside the Community.

The overall figures quoted cover risks of different types; loans to one country in the case of macro-financial assistance and loans for projects guaranteed by the borrowers in the case of NCI and EIB operations, for example.

The following analysis distinguishes between total risk, the risk in respect of Member States and the risk in respect of non-member countries.

---

[3] An average interest rate of 8% is assumed for EIB loans (fix and floating rate); the average interest rate assumed for borrowing and lending operations is 4,4%. An interest rate of 4,89% has been applied for the new operations in Table A3.

[4] The exchange rates used for loans in currencies other than the euro are those of 30 June 2002.

3.1. Amount outstanding at 30 June 2002

The total risk at 30 June 2002 came to € 15.118 million, as against € 15.443 million at 31 December 2001. Details are shown in Annex Table A1.

The following table shows the operations which have had an effect on the amount outstanding since the last report.

Table 1: Capital outstanding at 30 June 2002

	€ million
Amount outstanding at 31 December 2001	15.443
Loan repayments	
Euratom	0
NIC	0
Financial assistance	-23
EIB	-477
Loans disbursed	
Euratom	15
Financial assistance	12
EIB	255
Exchange rate differences between Euro and other currencies	-107
Amount outstanding at 30 June 2002	15.118

[1] All guaranteed loans (Member States, non-Member States) confounded.

The capital outstanding in respect of operations in the Member States was € 45 million at 30 June 2002, compared with € 52 million at 31 December 2001.

The capital outstanding from non-member countries at 30 June 2002 was € 15.073 million, compared with € 15.391 million at 30 December 2001.

3.2. Maximum annual risk borne by the Community budget: operations disbursed at 30 June 2002

For 2002 the total risk amounts to € 1.072 million.

– The risk in respect of the Member States comes to € 8 million.

– The risk in respect of non-member countries comes to € 1.064 million.

Details of the maximum annual risk are set out in Annex Table A2

3.3. Maximum theoretical annual risk borne by the Community budget

For 2002 the maximum theoretical risk amounts to € 1.104 million. It will increase from 2003 onwards and reach €4.128 million in 2010.

– The trend in the maximum theoretical risk in respect of Member States is almost the same as in Table A2.

– For the non-member countries it amounts to €1.095 million for 2002. The risk will increase from 2003 onwards to reach € 4.128 million by 2010.

Details of the maximum theoretical annual risk is set out in Annex Table A3.

4. ACTIVATION OF BUDGET GUARANTEES

4.1. Payments from cash resources

The Commission draws on its cash resources, under Article 12 of Council Regulation (EC, Euratom) No. 1150/2000 of 22 May 2000, implementing Decision 94/728/EC, Euratom, on the system of the Communities' own resources, in order to avoid delays and resulting costs in servicing its borrowing operations when a debtor is late in paying.

4.2. Activation of the Guarantee Fund

Council Regulation (EC, Euratom) No 2728/94 of 31 October 1994 established a Guarantee Fund for external action. In the event of late payment by a recipient of a loan granted by the Community, the Guarantee Fund is called on to cover the default within three months of the date on which is payment is due. If a borrower defaults on an EIB loan guaranteed by the Community budget, the Community will act within three months of receiving a letter from the Bank calling for the guarantee to be activated. The Commission will then authorise the Bank to take the corresponding amounts from the Guarantee Fund.

Default interest for the time between the date on which cash resources are made available and the date of activation of the Fund is drawn from the Fund and repaid to the cash resources.

In the last six months the Fund has not been called on to honour guarantees.

5. ANALYSIS OF THE COMMUNITY'S THEORETICAL LENDING AND GUARANTEE CAPACITY IN RESPECT OF NON-MEMBER COUNTRIES

In practice, the Guarantee Fund and reserve facility limits the Community's lending and guarantee capacity to non-member countries, since the appropriations available for provisioning the Fund whenever a new lending decision (or any annual tranche in the case of guarantees for multiannual operations) is adopted are limited by the amount entered for the guarantee reserve in the Financial Perspective[5].

[5] The figure entered in the 2000-2006 Financial Perspective is € 200 million at 1999 prices.

At any given time, lending capacity corresponds to the margin remaining in the guarantee reserve. This margin is equal to the difference between the reserve and the estimated amount needed to provision the Guarantee Fund for operations which have already been adopted and which are in preparation.

Table A4 shows an estimate of the Community's lending capacity in respect of non-EU countries over the period 2002-2004 in line with the Guarantee Fund mechanism. The method of calculation and references to legal texts are set out in greater detail in the Annex.

On the basis of the decisions adopted by the Council and decisions proposed and in preparation (see Annex Table A4), €171,39 million is expected to be used from the guarantee reserve in 2002, leaving € 41,61 million available at the end of the year.

If account is taken of the effect on the guarantee reserve of the provisioning of the Fund in respect of loans already decided and loans proposed and in preparation for 2002, the annual capacity available for loans is as follows:

– € 462,31 million for loans with a 100% guarantee under the Community budget, or

– € 711,24 million for loans with a 65% guarantee (in accordance with Council Decision 2000/24/EC of 22 December 1999).

At 30 June 2002, outstanding lending and loan guarantee operations for non-member countries totalled € 15.073 million.

Table 2: Outstanding lending and loan guarantee operations for non-member countries

€ million

	Situation at 30 June 2002
1. Capital outstanding, borrowing and lending	1.658
2. Capital outstanding, EIB	13.415
3. Capital outstanding, payments defaults	0
4. Default Interest	0
Unpaid interest due*	0
TOTAL	**15.073**

* unpaid interest due within the meaning of the Regulation establishing the Guarantee Fund

The ratio between the Fund's resources and outstanding capital liabilities, within the meaning of the Regulation establishing the Fund, was 11,39%, which is higher than the target figure of 9% set in Regulation No 1149/1999 amending Regulation No 2728/94 establishing the Fund. The rules state that at the end of a year the surplus shall be paid back to a special heading in the statement of revenue in the general budget of the European Communities.

The surplus at the end of the financial year 2001 was € 372,46 million.

6. SITUATION OF THE GUARANTEE FUND AT 30 JUNE 2002

At 30 June 2002, the Guarantee Fund amounted to € 1.815,5 million. The following movements were recorded in the first half of 2002:

- no call to the Fund as a result of further defaults;
- no late repayment (no arrears);
- net revenue of € 35,9 million on investments from the Fund's assets;
- no transfer from the 2002 reserve;
- an amount of € 372,46 million was repaid to the budget as Fund surplus as of 31 December 2001 in August 2002[6].

7. RELATIVE SOLIDITY

The ratio between the amount in the Fund at 30 June 2002 (€ 1.815,5 million) and the maximum annual risk for loans to non-member countries (defined as the total amount falling due) shown for 2002 in Annex Table A3 (€ 1.093 million) is 166 %.

6 For further details refer to the "Annual report from the Commission on the situation of the Guarantee Fund and its management during the year 2001".

Part Two:
Evaluation Of Potential Risks: Economic And Financial Situation Of The Non-Member Countries Benefiting From The Most Important Loan Operations

1. INTRODUCTION

The figures in Part One provide information on quantitative aspects of the risk borne by the general budget. However, this data should be accompanied by an assessment of the quality of the risk, which depends on the type of operation and the standing of the borrower. Recent events, which may influence the portfolio country risk, are analysed below.

The country risk evaluation presented in Part Two presents a table of risk indicators (see Annexes) for each non-member country that has received EC macro-financial assistance and still has outstanding debts to the EC. To complement this, textual analysis is provided for those countries where significant new information influencing the risk evaluation has become available since the previous report, which covered the last six months of 2001.

The evaluation in this Part does not deal with countries other than those mentioned, mainly because Community exposure elsewhere (notably through guarantees of EIB lending) is project related and also well diversified among countries.

2. ACCESSION COUNTRIES

Note can be taken of a general trend towards a reduction of the potential risks, although the income policy in Romania will require close monitoring.

2.1. Bulgaria

Real GDP growth was 4% in 2001 and 3,2% in the first quarter of 2002, thanks to sustained domestic demand arising from private consumption and investment which was strong enough to weather unfavourable external developments. Inflation decelerated to 7,4% on annual average and 4,8% at the end of the year. However, it increased again at the beginning of 2002 due to increases in administered prices and indirect taxes, but this tendency was reversed by low food prices in the summer of 2002.

The currency board arrangement (EUR 1 = BGN 1,95583) is being maintained and continues to be well covered by foreign reserves. It has not lead to a deterioration of external competitiveness given that inflation differentials vis-à-vis main trade partners were broadly matched by differences in productivity growth. In contrast to previous years, the current account deficit of 6% of GDP in 2001 was not exceeded by net inflows of foreign direct investment which were only about 5% of GDP. While a similar tendency appeared in the first half of 2002, an improvement can be expected for the second half of 2002 resulting from privatisation proceeds.

Registered unemployment was high at 17,3% on average in 2001, but ran lower in the first months of 2002 compared to the corresponding months of the previous year. Job losses are associated with structural reforms, including an accelerated process of privatisation, which have not yet been fully compensated by job creation, also because of some rigidities and mismatches on the labour market. As a result, the participation rate and the employment rate are relatively low and long-term unemployment remains high at more than 60% of total unemployed.

Fiscal discipline has been maintained over the last years. The general government sector had a deficit of 0.6% of GDP in 2000 and a surplus of 1,7% of GDP in 2001[7]. Public debt is falling rapidly, from well above 100% of GDP in 1997 to an expected 62% of GDP at the end of 2002. The government has embarked on an active debt management with the objective of reducing risks by gradually shifting from a denomination in US$ towards a denomination in euro, from short-term to long-term maturities, from floating into fixed interest rate bonds and from foreign to domestic financing.

2.2. Lithuania

Last year's strong economic performance has continued in 2002, despite the global economic slow down. In 2001, GDP grew by 5,9% and preliminary estimates for the first half of 2002 point to a growth rate of 5,8%. Exports and gross fixed capital formation developed strongly in 2001, even in the third and fourth quarter. However, the first quarter 2002 saw a significant slow down in growth of exports. Private consumption grew more moderately in 2001 but accelerated somewhat in the first quarter 2002. Public consumption has been constrained by the goal to reduce the budget deficit and grew by less than ½% in 2001.

Inflation has remained particularly low, despite strong growth and amounted to 1,3% on average in 2001. The price increase was mainly driven by food prices and prices for communications. However, these price rises were to some extent balanced by sizeable price reductions on petroleum products. In 2002, inflation has slowed down and stood at –1,1% in August, compared to the same period in 2001. Prices have gone down on several products and services including food, clothing and footwear, and furnishings, household equipment and routine maintenance.

The high unemployment level is one of Lithuania's greatest economic problems. Registered unemployment amounted to 12,5% in 2001 and according to the labour force survey 17,3%. However, whereas the unemployment remained stable in 2001 (disregarding seasonal variations), it has started to come down in 2002 and was about 1 ½ percentage point lower in July 2002 than one year before.

Strong export performance and rapid growth in 2001 have resulted in a further reduction of the current account deficit, from 6% of GDP in 2001 to 4,8% in 2002.

Lithuania has conducted a tight fiscal policy in order to cut down the budget deficit. In 2001 it came down from 2,7% of GDP in the previous year to 1,9%. In the coming years, the budget deficit might be expected to remain at about that level, as any further decline is obstructed by expenses related to structural reforms such as the pension reform, the savings restitution etc.

---

7 Following ESA95 methodology, the surplus in 2001 will be subject to a revision in the order of 1.5% of GDP, thus leading to deficit of between 0 and 1% of GDP.

2.3. Romania

Economic recovery strengthened in 2001 and proved resilient during the current year. After a modest rebound in 2000, growth accelerated to 5,3% in 2001 as investment and stocks increased and private consumption boomed on the back of rising real wages and income. Although the strengthening of domestic demand led to an increasingly negative contribution by the external sector to growth, exports continued to expand at double-digit annual rates until the last quarter of 2001, when growth slowed down sharply as the external economic situation worsened. The economic recovery, however, has been resilient so far. In the first quarter of 2002, GDP increased by 3,1% as import growth came to a near halt while exports rebounded somewhat and domestic demand continued to expand, albeit at a slower pace. Industrial production figures and trade data point to a continuation of these favourable trends over the second quarter of the year.

Contrary to past experiences, positive economic growth has been accompanied by greater domestic and external stabilisation. The adoption of a more coherent mix in the context of a new IMF stand-by arrangement was instrumental in halting the deterioration of the current account and supporting disinflation in the face of necessary increases in energy tariffs. On a declining path since mid-2000, inflation dropped more than expected in the first half of 2002 when the year-on-year rate fell some 6 percentage points to 24% in June 2002. Following two years of successful external consolidation, the current account deficit widened to 5,9% of GDP in 2001 on the back of the strengthening recovery and various one-off factors boosting import growth such as the effect of the 2000 draught on the domestic supply of agricultural goods and temporary fiscal incentives for capital investment by SMEs. However, the timely tightening of the fiscal and monetary policy in the second half of 2001 combined with rebounding goods export and lower prices for energy imports in the first half of 2002, and an underlying trend towards higher private transfers from abroad and lower service trade deficits lead to reverse the external deterioration. As a result, over the first half of 2002, the cumulative current account deficit fell by over a third compared to the same period in 2001. External financing conditions also continued to improve with a steady inflow of foreign direct investment, a persistently positive error and omission item in the balance of payment, and improving borrowing conditions. Reaping the benefits of various upgrades granted by rating agencies, Romania launched its first ten-year euro bond in April 2002.

Structural reforms have advanced further but at a slower pace than planned, as shown by long delays in the completion of the first and second reviews under the IMF Stand-by arrangement. The sluggish pace of privatisation, the persisting difficulty to control the wage bill and the arrears stock of public enterprises are two of the key sources of concern along with the agreement signed by the government with two trade unions in June 2002 that provides for a 50% increase in the minimum wage and a reduction in the minimum income tax in 2003. Safeguarding measures, including a tightening of the fiscal stance in 2003, were agreed only later with the IMF and will need to be strictly implemented to sustain stabilisation. In this regard, the sharp growth in money and credit observed since late 2001 also requires continued monitoring.

3. WESTERN BALKANS

Although economic indicators are generally improving, financial risk remains high in the region.

3.1. Bosnia and Herzegovina (BiH)

Official aid flows are declining, and sustained domestically generated economic growth is not yet apparent. Real output in BiH is expected to increase by just over 2% in 2002, similar to the level in 2001. Official estimates put unemployment at 40% of the labour force although the World Bank estimates the figure at broadly one half of this. Continued strict adherence to the rules of the currency board provides a solid anchor for low inflation. The downward trend has continued this year with an average inflation in 2002 expected to be broadly 2%. Public sector indebtedness is very high at potentially 150% of GDP including war claims and frozen foreign currency deposits. Fiscal performance remains unstable, there was still net arrears accumulation, and the general government budget deficit on a commitment basis remains high, 6,3% of GDP in 2001, and an expected 5,5% of GDP this year. Fiscal consolidation is however expected in 2002 and 2003, through the demobilisation of Federation soldiers, reforms to strengthen fiscal systems, and a prudent expenditure policy.

The current account deficit increased slightly in 2001 to 22% of GDP. Foreign direct investment (FDI) remains very weak with a decline in net FDI to $130m in 2001 compared with $150m in 2000, which is insufficient to fuel growth. Gross official reserves which increased to over five months of import cover in 2001, due to the increasing shift towards the use of the national currency in the context of the introduction of the Euro, should reach over 6 months of imports by the end of 2002. Although BiH remains current on its external debt service obligations, the balance of payments remains vulnerable due to large external deficits, high public sector indebtedness, declining foreign assistance and low private investment given the difficult political and business environment.

External debt was equivalent to broadly 58% of GDP at the end of 2001 and is expected to remain at this level over the medium-term. The ratio of debt service to exports is relatively low (5,1% in 2001), reflecting the concessional nature of much of the debt and favourable debt rescheduling, although this will increase in 2002 (7,5%) and beyond due to IMF and World Bank obligations. The Central State, which ensures external debt servicing obligations, has no fiscal resources of its own and relies upon budget contributions from the two Entities to fulfil its obligations. BiH is not rated by the credit rating agencies and EBRD transition indicators, reflecting progress in reforms in Central and Eastern European countries, place BiH towards the low end of the scale.

Following the completion of the previous IMF Stand-By Arrangement (SBA) in May 2001 (signed in May 1998), a new 15-month SBA (August 2002 – November 2003) was finally approved by the IMF Board on 2nd August 2002 for the new US$ 89 million programme The programme aims at strengthening economic activity and the external accounts in the near and medium-term, in particular, sizeable declines in the current account deficit and strong international reserves.

3.2. Federal Republic of Yugoslavia (FRY)

The outlook for the FRY's debt servicing capacity is broadly unchanged. In the first half of 2002, economic policies in the FRY continued to be geared towards restoring and sustaining macro-economic stability, liberalising the price, exchange, trade and tax regimes, and reforming the economy on the basis of new legal and regulatory frameworks established in 2001.

Confidence in the domestic currency strengthened and the value of the Dinar remained broadly stable at around YuD 59 per EUR in 2001 and the first quarter of 2002. Gross reserves of the National Bank of Yugoslavia rose from around US$ 1.200 million by end-2001, equivalent to 2,6 months of imports, to US$ 1.500 million in the first quarter of 2002.

Even if the FRY continues with macro-economic stabilisation and sustains a good track record in structural reforms as envisaged under the new IMF programme adopted in May 2002 (a three-year Extended Arrangement from 2002- 2005), the external sustainability of the FRY economy will remain a challenge. Important financing requirements, mainly resulting from debt service obligations and the need to further strengthen foreign exchange reserves, will continue to put a heavy strain on the balance of payments. The FRY's capacity to absorb new debt is limited and a cautious approach to new sovereign lending is warranted. Noteworthy is the substantial debt relief (66%) that is being provided by the Paris Club following the approval of the new IMF programme. However, the level of external debt to GDP will remain relatively high in 2002-2004 at 69%. Also, debt service obligations will rise considerably from around US$ 100 million in 2001 (3,9% of goods and services) to US$ 350 million (10,9%) and US$ 470 million (12,9%) in 2002 and 2003, respectively.

3.3. Former Yugoslav Republic of Macedonia (fYRoM)

The fYRoM is recovering from the 2001 security crisis that affected the performance of the economy. In 2002, GDP is expected to grow by 2,5-3%, against a decline of 4,1% last year. In the first five months of 2002, consumer prices increased by 3,5% with respect to the first five months of 2001.

The recently revised 2002 budget foresees central government deficit at 2,3% of GDP and general government deficit at 3% of GDP, compared to a deficit of 6,4% in 2001. Nevertheless, the perspective of parliamentary elections (September 2002) led earlier this year to a relaxation of the commitment to fiscal sustainability over the medium-term, which caused the breakdown of talks with the IMF during the revision of the Staff Monitored Programme and to the failure of negotiations on a new stand-by arrangement.

The trade deficit increased over the first semester 2002. A sharp increase of exports would be needed over the second half of the year to meet official projections of a US$ 532 million deficit in 2002. Due to an expected increase in public and private transfers, the current account deficit should slightly decline to 9,2% of GDP in 2002 (without taking into account donors' financing), compared to a deficit of 10,1% in 2001.

The current account deficit is not expected to be fully covered by net capital transfers, leading to a possible decline of reserves over the year 2002, from their level of six months at the end of May 2002. The external debt as ratio to GDP should increase from 40,7% in 2001 to 42,4% at the end of 2002, a level which however is considered as sustainable.

On the short-term, risks relate mainly to the decision to liberalise capital account transaction in mid-October 2001 - especially in the absence of an IMF programme ensuring a consistent macroeconomic framework. On the medium-term, in spite of broadly orderly held elections in September, the main risks are associated to the settlement of ethnic tensions, as well as to a number of uncertainties on the economic policy of the new majority in the Parliament.

4. NEWLY INDEPENDENT STATES

The risk situation remains globally stable with, however, important differences amongst countries.

4.1. Armenia

Strong economic growth continued in the first half of 2002 with a real GDP growth rate of nearly 10% compared to the first half of 2001. Growth was driven by the industrial sector, mainly owing to a recovery in the diamonds processing sector but also other industrial sectors such as metallurgy and food processing have picked up. In agriculture, on the other hand, growth will slow down this year, because of unfavourable weather conditions.

The Government continues its efforts to tighten the fiscal policy. The central government budget for 2002 aims at a deficit of not more than 3% of GDP (further down from a deficit of 3,8% in 2001). This seems to be attainable on the basis of the improved tax collection rates which were realised in the first half of 2002.

Consumer prices were fairly stable in early 2002 but later in the spring inflation was triggered as government expenditures increased when some of the outstanding expenditure arrears in pensions and social transfers were paid. Consumer price inflation is forecast to average about 3% in 2002 (3,2% in 2001) owing mainly to higher food prices.

As a result of strong growth in exports (+20,8%) and moderate growth in imports (+1,2% only, due to ongoing import substitution), the current account deficit declined in 2001 to about 9,5% of GDP from 14,5% in 2000, official transfers included. This trend has continued in 2002, and according to preliminary trade figures, the deficit will continue to narrow further this year. Inflows of foreign direct investment, on the other hand, have been on a downward trend after 1998, and the decline continued in early 2002. Armenia's external debt stock was US$ 917 millions (about 43% of GDP) at end-March 2002. The Central Bank's gross international reserves are at a fairly comfortable level, equivalent to 3,8 months of imports.

4.2. Belarus

Russia's willingness to accept payment arrears or extend soft loans is expected to be of major help in financing Belarus' balance of payments imbalances, in the absence of foreign direct investment (FDI) inflows or Western credits. In mid-June 2002, Belarus received from Russia the second tranche of its stabilisation loan, shortly after it agreed to a plan outlining preparatory measures to be undertaken in advance of the introduction of a single currency in 2005. Russia has agreed to lend Belarus Rb 4,5bn (US$142 million)) to help stabilise the Belarusian currency, in three equal Rb 1,5bn tranches. Aside from Russia, Belarus has few other sources of external funding. This is the primary reason behind the government's low level of indebtedness. In May 2002, the total foreign debt stock stood at US$ 785 million or a mere 6% of GDP, according to official sources. In addition, Belarus still owes US$ 265m to Russian natural gas suppliers, most of which was accumulated prior to 2001. This debt has been a subject of negotiation for more than three years.

The Belarusian economy continues to grow year on year at around 3-4%. However, industrial growth has slowed, and many enterprises remain non-profitable. Inventories have grown sharply, and investment lags. State-controlled agriculture is in poor financial shape. Export growth stagnated over the first four months of 2002. Modest import growth over the period brought a rise in the trade deficit. The authorities continue to avoid structural reforms, despite the privatisation plans that were outlined in its new programme. The budget deficit over the first four months of 2002 equalled 0,7% of GDP. Inflation has slowed, which has allowed interest rates to fall, but recent money supply growth could reverse this process. The currency's depreciation against the Russian rouble has remained within the targets set by the central bank's crawling-peg arrangement, although this has put a strain on international reserves. There are no prospects for an IMF lending programme in 2003.

4.3. Georgia

The recovery in economic growth in 2001 was driven by agriculture, transport and retail trade (4,5% for year as a whole). Preliminary data for the first half of 2002 show real GDP growth of 4,2%. Fewer disruptions in the energy sector contributed to a rebound in industrial production (5,2% in January-June 2002) and construction activity was particularly strong in the oil transport sector where major investment projects are underway. Depressed export volume growth and low investments in manufacturing are, however, constraining any higher growth rates. In addition, this year’s agricultural production has been affected by floods in parts of the country.

The government has taken some measures to improve revenue collection, and it has been able to reduce the stock of expenditure arrears while an overall expenditure restraint has been maintained. The year 2002 budget aims at an increase in the tax-to-GDP ratio for the general government from 14,25% in 2001 to 14,75% , reducing thereby the general government deficit further from 2% of GDP in 2001 to about 1% .

The lari was stable for most of 2001, but depreciated by about 6% between November 2001 and February 2002. This led to an increase in inflation which was further fuelled by increases in utility prices in early 2002. The year-on-year inflation rate was at 7,5% in May 2002. In 2001, consumer price inflation averaged 4,7%.

In December 2001 the Parliament introduced a ban on the export of non-ferrous scrap metal, which is Georgia’s main export item. Accordingly, there was a slump in export revenues in the first half of the year. Given that the ban has again been lifted in June 2002, export revenues are expected to resume in the second half of the year. Nevertheless, since agricultural exports have suffered from bad weather conditions, export revenue growth will be modest for the year as a whole. Georgia’s external debt stock is about US$ 1,7 billion (about 51% of GDP), and its net present value currently amounts to over 300% of central government revenues. Because of the projected increase in the debt service from 2003 onwards, Georgia is expected to seek an additional rescheduling of its bilateral debts. The National Bank’s gross international reserves have increased, but in relation to imports they still remain low, equivalent to about 1,3 months of imports.

4.4. Moldova

The recent resumption of multilateral financing and the recovery of the Moldovan economy have provided the country with some financial breathing space. In addition, Moldova is expected to complete its Eurobond restructuring. This will help to ease the government's liquidity problems. However, debt-servicing will remain difficult.

Moldova's economic recovery has continued from last year's 6% expansion, with real GDP up by 4,8% year on year in the first quarter of 2002 . Strong industrial growth continues to drive growth, spurred by export sales to Russia and rising domestic demand. In particular, double-digit real wage growth has helped achieve an 11% year-on-year increase in retail sales over the first five months of 2002.

Moldova's economy nevertheless remains extremely fragile, and continues to present significant overall economic and financial risks. It remains narrowly based on agriculture and agro-processing, so that adverse weather conditions could produce a sharp downturn in overall economic growth. As the economy continues to suffer from a decline in investment, the rate of diversification away from agriculture-related sectors and wine sales to Russia remains slow. Moreover, the government has shown numerous signs that it hopes to reassert a degree of state control in the agricultural sector, which would almost certainly preclude the investment inflows needed to succeed with post-privatisation reforms.

A seasonal reduction in food prices in June helped bring inflation down to 4,3% year on year, its lowest point since the 1998 financial crisis. Inflation will rise again during the remainder of 2002, as scope diminishes for further sharp reductions in food prices. There is also a risk of policy loosening, given the government's revenue-collection difficulties. Combined with increases in electricity tariffs, this is likely to boost inflationary pressures in the next few months above what might be expected from seasonal factors. Nevertheless, following recent progress on debt restructuring and the resumption of multilateral financing, the central bank is expected to maintain a broadly appropriate monetary stance and a sharp increase in inflation remains unlikely.

4.5. Tajikistan

Tajikistan's real GDP growth accelerated to 10,2% in 2001, and strong economic growth has continued in 2002 with an annual GDP increase of 10,3% reported for the first half of the year. Output in agriculture picked up 17,2% and industrial production increased by 7.8% year-on-year driven by the aluminium sector.

The Government targets a deficit of one percent of GDP in the general government in 2002 (0,1% deficit in 2001). Total expenditures have been driven up owing to a 40%-increase in public sector wages. Also defence related expenditures are projected to increase. Nonetheless, preliminary figures for the first half of year indicate that the government finances are in surplus so far.

Inflation moderated rapidly over the year 2001 to 12,5% at year-end. In the January-July 2002 period, consumer price inflation was 6,6%. The National Bank of Tajikistan pursues a restrictive monetary policy consistent with the goal of reducing the inflation rate to 10% for the year 2002, and it is therefore committed to refraining from issuing directed credits which have been a source of excess liquidity in the past.

Because of a decline in world market prices for both cotton and aluminium, the current account position deteriorated in 2001 to a deficit of 7,2% of GDP but it is projected to improve in 2002 to about 6% of GDP. Tajikistan's external debt amounts to about US$ 1 billion (close to 100% of GDP). Annual debt service payments remain high at about 50% of government revenues, and Tajikistan pursues discussions on debt rescheduling with its bilateral creditors, most importantly with Russia and Kazakhstan. The National Bank's gross international reserves corresponded to 2,1 months of imports at the end of 2001. In 2002, the reserves are projected to decline to about 1,5 months of imports due to early repayments to the IMF.

4.6. Ukraine

Ukraine's rate of economic growth decelerated from 9,1% in 2001 to 4,3% in the first half of 2002 year-on-year. A weakening of export performance, partly reflecting the real appreciation suffered by the hryvnya in 2000-01 and weaker demand in Russia, and a smaller harvest following last year's record one are among the factors explaining this deceleration. Growth, which is now largely driven by domestic demand, is expected to be around 4,5% this year but should pick up again moderately in 2003-04 supported by the strengthening of global demand. There are however significant downward risks to this forecast stemming from the need to tighten fiscal policy, insufficient progress with structural reform and lack of political consensus.

Inflation has continued to surprise in the downside. In the first 8 months of the year, the CPI fell by 3,5 percent. This partly reflects the delayed effects of last year's exceptional harvest on the food component of the CPI, which has a large weight in the index, and the stability of the currency. But it is also explained by the postponement of energy price adjustments, which are still controlled by the government. The need to increase energy prices and the recent acceleration of wage growth (wages are increasing at an annual rate of about 20%) are likely to push inflation back to a 5-7 percent range in 2003-04.

Despite a significant revenue shortfall, the central government managed to close the first half of 2002 with a small surplus, partly reflecting the implementation of expenditure cuts. This seems consistent with the target of 1,8% of GDP for the consolidated government deficit foreseen in the 2002 budget. This result, however, has been possible in part because the government has failed to clear the substantial arrears accumulated on VAT refunds. Moreover, a marked shortfall in privatisation revenues, which partly reflects the government's decision to delay until next year the privatisation of the regional electricity distribution companies and the state-owned telecommunications monopoly, could complicate the government financing outlook in the remainder of the year. The lack of progress in resolving the VAT refunds issue and the insufficient implementation of other fiscal and structural measures led the IMF to announce in early August the cancellation of any new disbursements under the EFF.

With domestic demand keeping import growth strong and export growth decelerating due to subdued foreign demand and the appreciation of the real exchange rate, the surplus in the current account is projected to narrow to about 1,5% of GDP in 2002. Gross international reserves have continued to increase, reaching US$ 3,82 billion, or about two months of imports, at end-July 2002. Ukraine, which lost access to the international capital markets in the wake of the Russian crisis of 1998 and defaulted on its Paris Club debt in early 2000, has made substantial progress in recent years towards the normalisation of relations with its creditors. This has included the rescheduling of part of its private bond debt in April 2000 and of its Paris Club debt in July 2001. The government intends to return to the international capital markets in the coming months with the issuance of a bond. Ukraine's external debt stock stood at the equivalent of about 30% of GDP at end-2001. There is significant uncertainty as to whether the EFF, which expired in September 2002, will be replaced by a new IMF arrangement.

5. Other Non-member Countries

5.1. Algeria

A relatively stable macroeconomic environment continues to prevail in Algeria, while no major structural changes can be observed. The economy is expected to grow by around 3,3% in 2002 (from 2,1% in 2001), with stimulus coming from both the fiscal and monetary policy. The 2002 consolidated fiscal deficit is expected to account for 3% of GDP and might, together with a credit expansion, lead to an inflation rate of around 6% in 2002. Despite its rich resources, Algeria's economy remains plagued by a number of structural problems such as its dependence on hydrocarbon exports sector (>95% of exports, 30% of GDP) and the weight of its agricultural sector. Furthermore, its domestic security problem strongly undermines investment activities.

The latest period of high oil prices is still impacting positively on Algeria's external accounts. Algeria is expected to maintain a current account surplus in 2002 (2,3% of GDP), although at a lower level than in 2000-2001, as receipts from oil and gas exports have started to decline. The oil windfall of the last two years reduced Algeria's foreign debt level to around US$ 21 bn (39% of GDP) in June 2002, while the debt-servicing ratio remains at a moderate level of around 27% of total current receipts. Consequently, foreign exchange reserves rose to more than US$ 19 bn in June 2002, covering more than a year of imports, thus comforting the strong external position of the country.

List of abbreviations

DM	Deutsche Mark
EC	European Community
EFF	Extended Fund Facility
EIB	European Investment Bank
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMF	International Monetary Fund
SBA	Stand-By Arrangement
US$	Dollar of the United States of America