Belarus Economy Monitor:
trends, attitudes and expectations

Monetary Environment Review
Q1-2024

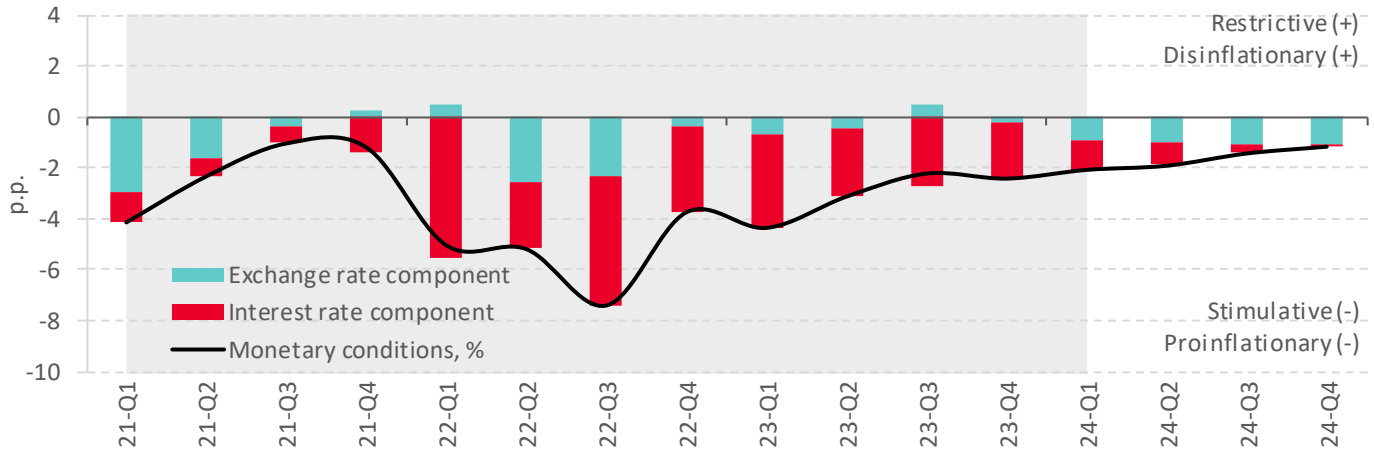
May 2024

Monetary stimulus will shrink in 2024, but not enough to address threats to macroeconomic stability

Monetary conditions remained loose in Q1-2024 in Belarus, but the stimulus they generated for economic activity decreased due to higher interest rates in the credit and deposit market (Figure 1). The foreign exchange rate provided limited support to the price competitiveness of Belarusian producers and a moderate pro-inflationary impact at the beginning of 2024.

In the context of growing overheating of the Belarusian economy and expanding risks for price stability, we can expect a further narrowing of the monetary stimulus from market interest rates because of the National Bank's actions (Figure 1). At the same time, the National Bank's response to threats to macroeconomic stability is expected to be limited and delayed due the Bank's lack of independence from the executive branch.

Figure 1. The nature of monetary conditions in the Belarusian economy



Source: The calculations are based on the Quarterly Projection Model (QPM) for Belarus.
Note: Monetary conditions are estimated as a combination of deviations of real interest rates on the Belarusian ruble assets and of the real effective Belarusian ruble exchange rate from their equilibrium levels. Positive monetary condition values indicate their restraining-economic-activity and disinflationary nature, and negative monetary condition values indicate their stimulating and pro-inflationary nature. We use one of the ways to assess monetary conditions, the results of which depend on the chosen type of the macroeconomic model (QPM) and its specification. We are aware of the limitations of the approach applied.

The Monetary Environment Review Bulletin presents an expert analysis of the monetary and foreign exchange rate policies and the resulting monetary conditions in the Belarusian economy. The bulletin reviews the actions under the monetary and exchange rate policies, their impact on the economy, the nature of monetary conditions, and provides their short-term forecast. The methodological basis for the analysis is the Quarterly Projection Model (QPM) for the Belarusian economy.

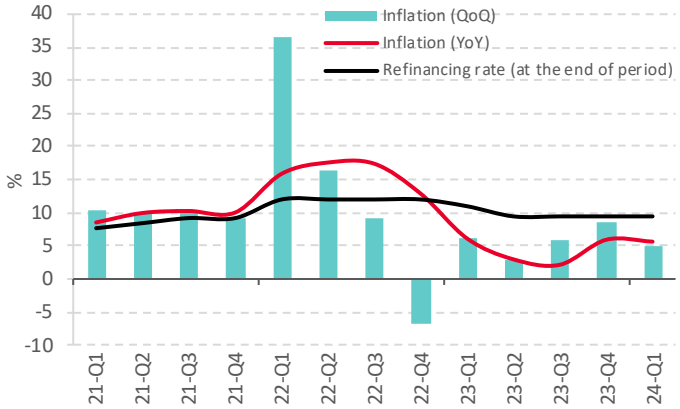
1 Monetary policy: measures, direction, nature

The National Bank responded cautiously and belatedly to the growing overheating of the economy and increasing inflation risks

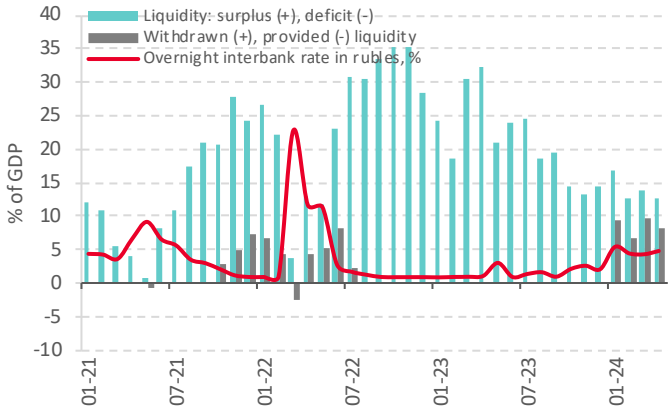
In Q1-2024, the National Bank increased reserve requirements for banks' obligations in foreign currency and provided access to standing facilities to banks again. These measures helped limit the excess liquidity of banks and eliminated their incentives to place free resources on the interbank market at interest rates lower than the lower threshold of the National Bank's interest rate corridor (the overnight deposit rate was 4% in Q1-2024). As a result, the interbank loan rate increased from 2.4% in Q4-2023 to 4.8% in Q1-2024 (Figure 2.b). At the same time, since the liquidity surplus remained in the banking system, and the National Bank did not conduct auction operations to withdraw this liquidity surplus and did not increase the refinancing rate (Figure 2.a), the interbank loan rate remained below its neutral level. As a result, **monetary policy continued stimulating economic activity in Q1-2024, but the stimulus decreased** (Figure 2.c). QPM-based estimates illustrate that even with price controls in place, the interbank lending rate should have been in the range of 7–8% in Q1-2024 to limit risks to macroeconomic stability.

Figure 2. Dynamics of monetary policy indicators

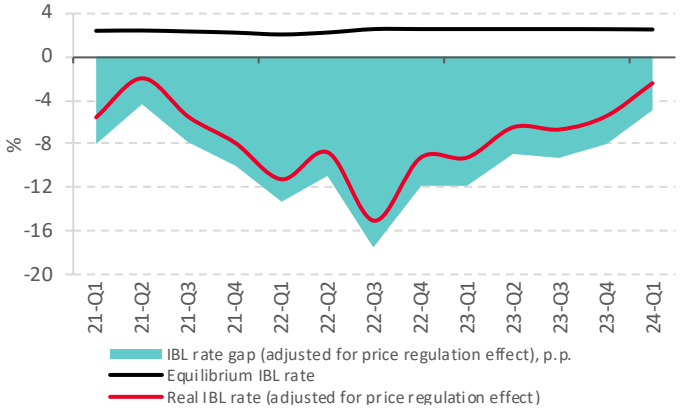
a) refinancing rate and inflation



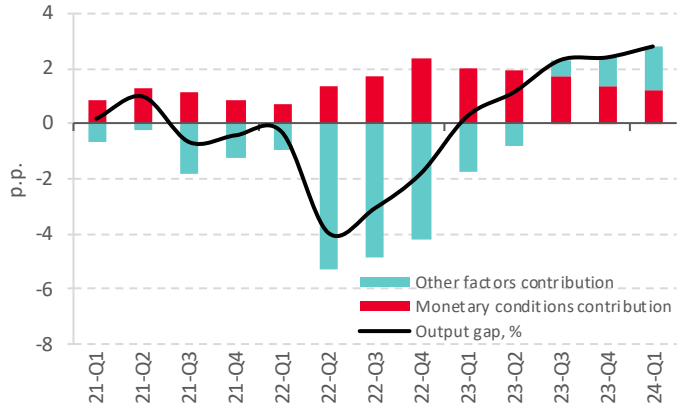
b) banking system liquidity (monthly average)



c) real and equilibrium interbank rate[i] (quarterly average; QPM-based)



d) contribution of monetary conditions to the output gap (QPM-based)



Source: The calculations are based on the data by Belstat, National Bank of Belarus, QPM.

Note: Hereinafter, YoY is the growth rate in the last month of the quarter versus the last month of the corresponding quarter of the previous year; QoQ is the annualized growth rate in the last month of the quarter versus the last month of the previous quarter, seasonally adjusted.[ii]

Restrained growth of the interbank lending rate and its expected sticking to the lower limit of the interest rate corridor was the outcome of the extremely careful steps taken by the National Bank in the environment of its subordination to the Government and the Presidential Administration

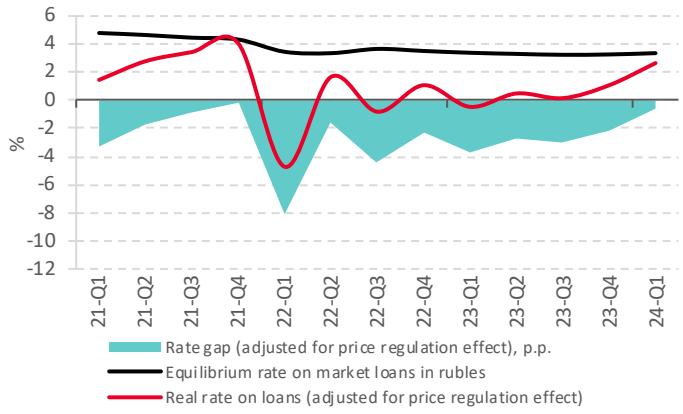
The lagging nature of the monetary policy makes it not a sink, but an accelerator of shocks, which, together with degraded communications, undermines the National Bank credibility. As a result, loose monetary conditions continued to support excess demand in the Belarusian economy, and the positive output gap in Q1-2024 was QPM-estimated at ≈2.8% (Figure 2.d). Combined with the tense situation in the labor market, overheating of aggregate demand increased inflationary pressure, which was contained by blanket price controls by the government. The inflationary overhang accumulated in this environment, and it could reach at least 6% by the end of Q1-2024.

Interest rates on loans and deposits in Belarusian rubles grew in Q1-2024, but, on average, they remained below their equilibrium (neutral) levels

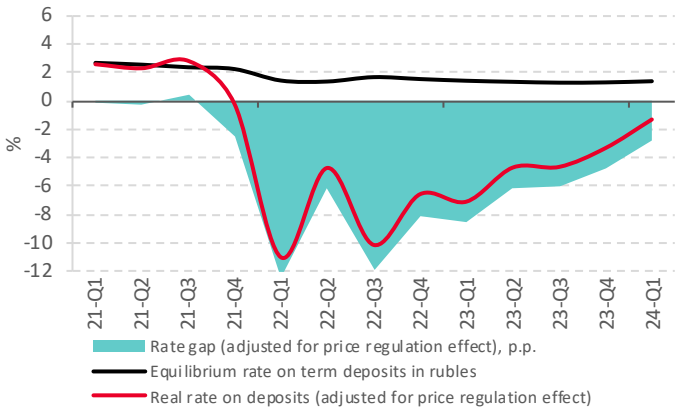
The average nominal interest rate on new time Belarusian ruble deposits in Q1-2024 increased by 1.4 percentage points (to 5.9%) versus the average value in Q4-2023.[iii] The average interest rate on market Belarusian ruble loans grew by 1 percentage point, to 10.0%.[iv] The increase in credit and deposit market interest rates was a consequence of more expensive monetary resources in the interbank market. Real interest rates on loans and deposits increased in Q1-2024, following an increase in nominal interest rates. As a result, their stimulating effects on economic activity and inflation faded, but **real interest rates remained below their equilibrium levels estimated through QPM** (Figure 3). It should be noted that in terms of Belarusian ruble market loans, interest rates have approached the neutral level and, if inflation expectations are stable, the rates may move into their neutral values in 2024. In terms of time deposits, low returns remained in the segment of corporate deposits, while interest rates on households deposits were most likely close to their equilibrium levels. The latter is indicated by the strong growth in the share of households income allocated to time deposits in Belarusian rubles in Q4-2023 and in Q1-2024: its size returned to the levels of the second half of 2019.

Figure 3. The nature of real interest rates on Belarusian ruble loans and fixed-term deposits in banks

a) average rate on new market Belarusian ruble loans (quarterly average)



b) average rate on new fixed-term Belarusian ruble deposits (quarterly average)



Source: The calculations are based on QPM.

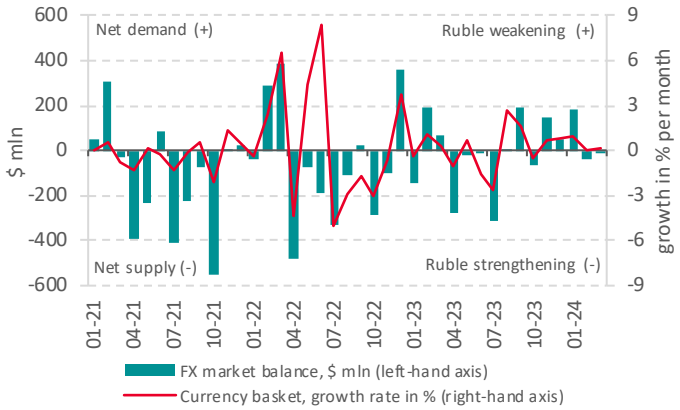
Note: Real interest rates have been calculated on the basis of average nominal interest rates for businesses and households (according to the National Bank data) and the expected annual inflation in the next quarter (QPM-based).

2 Exchange rate policy: measures, direction, nature

The Belarusian ruble weakened moderately in Q1-2024

Figure 4. Dynamics of the foreign currencies basket and of international reserve assets

a) FX market and foreign currencies basket



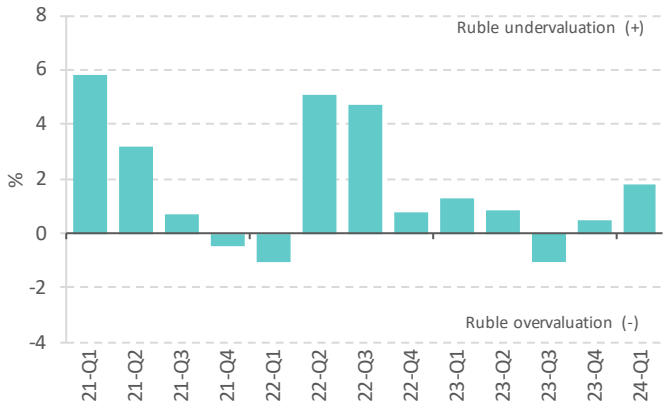
b) international reserve assets (at the end of the period)

Source: The calculations are based on the data by the National Bank of Belarus.
Note: Figure 4.a illustrates the basket of 3 currencies (US dollar, euro and Russian ruble) from January 2019 to June 2022, and the basket of 4 currencies (US dollar, euro, Russian ruble, and Chinese yuan) from July 2022 to December 2022, and the basket of 3 currencies (US dollar, Russian ruble, and Chinese yuan) from January 2023 onwards. The X13 procedure was applied to make a seasonal adjustment. The dynamics updates once new data are published.

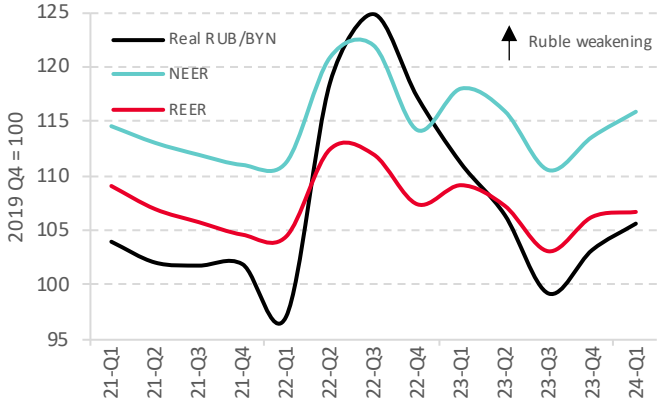
On average, the value of the basket of 3 foreign currencies increased by 1.6% in Q1-2024 versus Q4-2023. In terms of the nominal effective exchange rate, the Belarusian ruble weakened by 2% over the same period (Figure 5.b). Exchange rate fluctuations against individual foreign currencies were mainly determined by the dynamics of their cross rates in foreign markets: over Q1-2024 on average, the Belarusian ruble weakened by 0.3% against the US dollar, by 0.6% against the yuan, and by 2.4% against the Russian ruble. The National Bank smoothed out the volatility of the exchange rate through its interventions: its sales of foreign currency (balanced with the operations of the Ministry of Finance) amounted to $139 million in Q1-2024 (Figure 4.a).

Figure 5. Effective Belarusian ruble exchange rates and deviations of the Real Effective Exchange Rate from the equilibrium level (QPM-based)

a) deviation of the Real Effective Exchange Rate from its equilibrium



b) Belarusian ruble exchange rates



Source: The calculations are based on the data of the National Bank of Belarus and QPM.
Note: These are the Nominal Effective Exchange Rate (NEER) and the Real Effective Exchange Rate (REER) of the Belarusian ruble.

International reserve assets increased by $225 million in Q1-2024 due to rising prices for gold

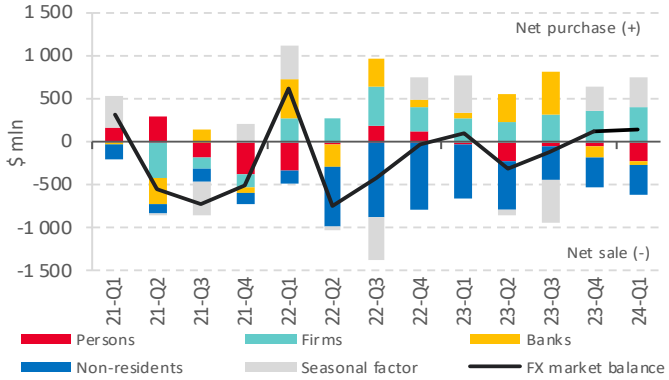
The sufficiency of reserves remained low by the beginning of Q2-2024: their size is estimated at about 2.1 months of imports of goods and services (Figure 4.b), and their most liquid component in foreign currencies is estimated at about 0.8 months of imports of goods and services.

The weakening of the Belarusian ruble manifested in its slight undervaluation in terms of the Real Effective Exchange Rate in Q1-2024

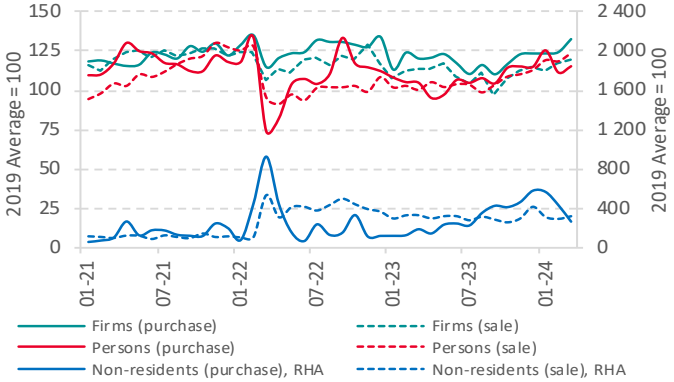
The exchange rate factor supported price competitiveness of Belarusian producers at the beginning of 2024; however, this support was limited and smaller compared to the first half of 2021, and in summer and autumn of 2022 (Figure 5.a). The observed scale of undervaluation of the national currency had a restrained pro-inflationary effect. At the same time, the direct effect of the foreign exchange rate pass-through to consumer prices, associated with the impact of the foreign exchange rate on the cost of imports, intensified in Q1-2024.

Figure 6. State of the domestic foreign exchange market

a) foreign exchange market balance (seasonally adjusted segments)



b) dynamics of the foreign exchange market indicators (seasonally adjusted)



Source: The calculations are based on the data by the National Bank of Belarus.
Note: The X13 procedure in the JDemetra+ app has been applied to make a seasonal adjustment. As new data are published, the dynamics of the indicators for the previous periods is updated.

In Q1-2024, the Belarusian ruble weakened due to the seasonally high demand for foreign currencies and a small deficit in foreign trade in goods and services

Resident firms consistently remain to be net buyers of foreign currency. In turn, net sales of foreign currency by non-residents decreased in Q4-2023 — Q1-2024. As a result, the total balance of foreign exchange transactions of resident firms and non-residents was positive (seasonally adjusted) (Figure 6.a). This dynamics can be explained by a small deficit in foreign trade in goods and services shaped in Q1-2024 in an environment of excess demand in the Belarusian economy. It is also impossible to exclude the impact of decreasing import flows to Russia through Belarus.

The foreign exchange market was supported by retail transactions of households. Despite booming income growth in a labor-scarce environment, households sold more than $0.2 billion on a net basis (seasonally adjusted) in Q1-2024 (Figure 6.a). It is likely that higher risks of investing in foreign currency in the context of sanctions pressure are manifested in an increasing demand for savings in Belarusian rubles and the purchases of real estate, and these risks also trigger incentives to consume more.[v] Foreign exchange activity in banks may have seen a slight net sale of foreign currency in Q1-2024 (Figure 6.a).

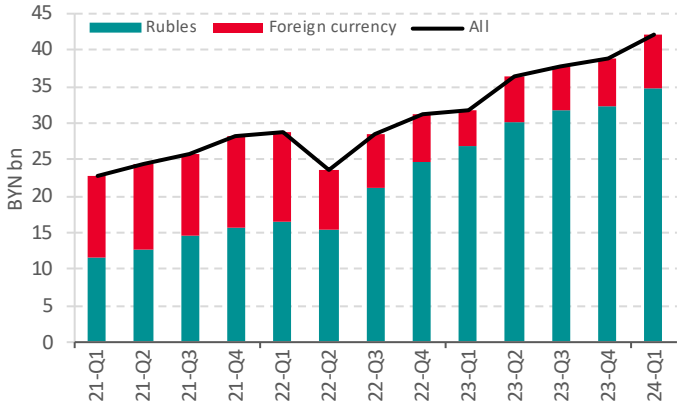
3 Impact of monetary conditions on the credit and deposit market

Lending activity strengthened in Q1-2024 amid continued loose monetary conditions and the likely continuation of active directed lending practices

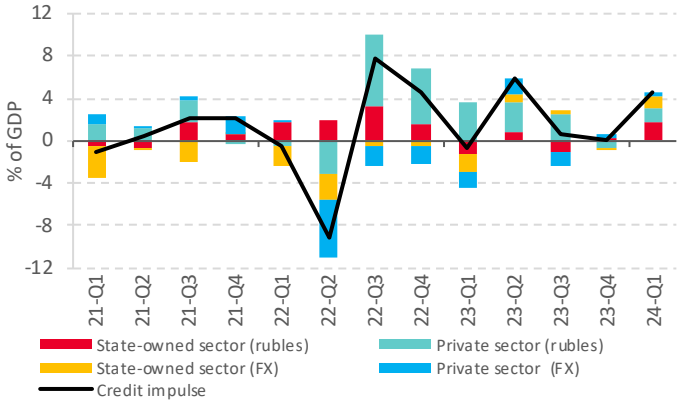
In Q1-2024, credit impulse grew noticeably because new lending volumes expanded (Figure 7.b). The volume of loans issued was ca. 66% higher than the 2021 average (Figure 7.a), and relative to GDP, it reached ≈73%. For example, new loans accounted for 59% of GDP in 2017, about 64% of GDP in 2018–2019, and 57% of GDP in 2021. Credit activity appears elevated relative to the equilibrium level, which maintains output in the economy at a supra-optimal level (Figure 2.d).

Figure 7. Dynamics of new loans issued and credit impulse

a) volume of new loans issued (seasonally adjusted)



b) credit impulse (QoQ, seasonally adjusted)



Source: The calculations are based on the data by the National Bank of Belarus, Belstat.

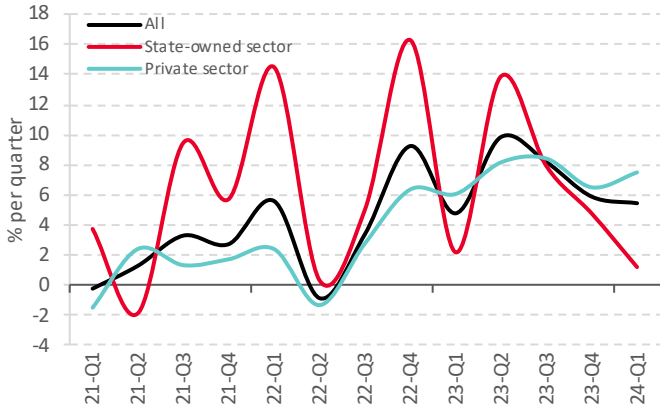
Note: The credit impulse has been calculated as follows: $ci_t = 100 * \left(\frac{cr_t}{ngdp_t} - \frac{cr_{t-1}}{ngdp_{t-1}}\right)$, where ci_t is the credit impulse during period t; cr_t is the seasonally adjusted scope of newly issued loans during period t; $ngdp_t$ is the seasonally adjusted volume of the nominal GDP during period t. The X13 procedure in the JDemetra+ app was applied to make a seasonal adjustment. The indicator dynamics updates once new data are published.

Maintaining a high output volume requires greater credit support in the context of the deteriorating financial standing of enterprises

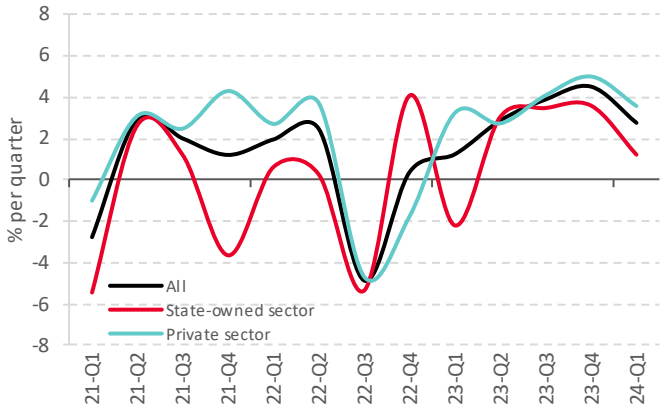
Despite the increased scope of new lending, credit debt (mainly in the corporate segment), which takes repayments of previously issued loans into account, slowed down in Q1-2024 (Figure 8). This could mean that an increasing share of firms' new borrowings repay their debts. It is likely that in an environment of blanket price controls in the domestic market and deteriorating price terms of trade in foreign markets, maintaining high output volumes requires an increasingly large volume of new credit injections, and loose monetary conditions support a favorable environment for this process. Maintaining a stimulating monetary policy and active directed financing will increase risks for macroeconomic stability in this environment.

Figure 8. Dynamics of bank loans stock (quarterly growth, seasonality adjusted)

a) liabilities nominated in the Belarusian ruble



b) debt on all loans



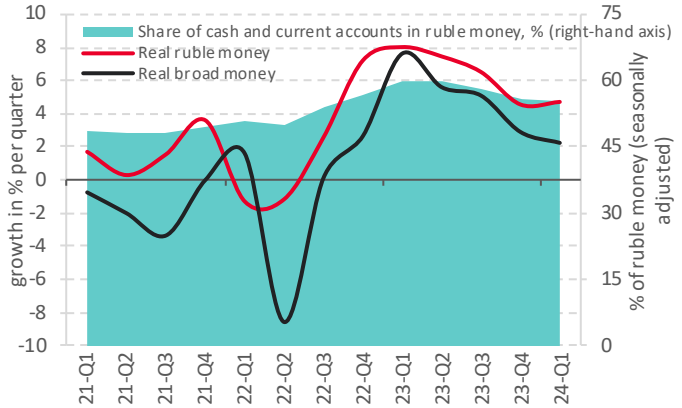
Source: The calculations are based on the data by the National Bank of Belarus.
Note: The indicator dynamics updates once new data are published.

Broad money supply continued growing at rates outpacing inflation-neutral rates in an environment of strong lending activity

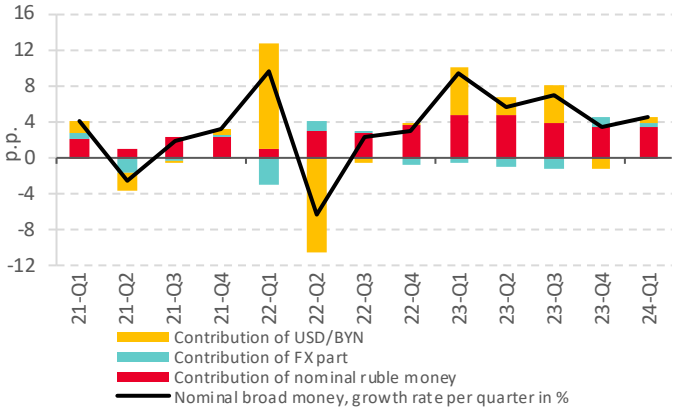
Broad Money Supply (M3) increased by ≈3.9% in Q1-2024 in nominal terms (this is the average value for Q1-2024 versus the average value for Q4-2023) or by ≈2.3% in real terms (all indicators seasonally adjusted). M3 growth continued to be driven by the Belarusian ruble component (Figure 9.b), which grew by 6.4% and 4.8% respectively over the same period (Figure 9.a). The M3 dynamics significantly outpaced GDP growth, and this advance has been recorded for the sixth quarter in a row. Cumulatively, nominal M3 growth outpaced nominal GDP growth by 24 p.p. from Q4-2021 through to Q1-2024. Even if we assume that in pre-war Q4-2021 the volume of broad money supply was slightly below its equilibrium level, and the importance of domestic sources of financing increased after the introduction of sanctions, such a scale of advancing money supply growth over GDP growth creates a significant impulse for expanding demand in the Belarusian economy. If monetary conditions do not transit to a neutral state at least, the money supply dynamics may remain excessive versus GDP growth, which will support excess demand and pro-inflationary pressure in the economy.

Figure 9. Average money supply dynamics (seasonally adjusted)

a) average real money supply



b) decomposition of the nominal M3 growth



Source: The calculations are based on the data by the National Bank of Belarus, Belstat.
Note: M3 is a broad money supply. The indicator dynamics updates once new data are published. Real money supply growth is estimated by deflating nominal growth (quarterly average versus previous quarterly average) by the change in the Average Quarterly Consumer Price Index (seasonality adjusted).

4 Monetary conditions short-term forecast

The National Bank will continue to be late in responding to inflation risks due to lacking independence and challenged internal communications

The refinancing rate (to which the costs of directed loans are tied) is projected to be close to the current level of 9.5% in 2024 (Figure 10.a). The National Bank is currently unable to change the refinancing rate without getting approval from the Government and the Presidential Administration, and the directed lending instrument will continue to be actively applied to counter the economic downturn.

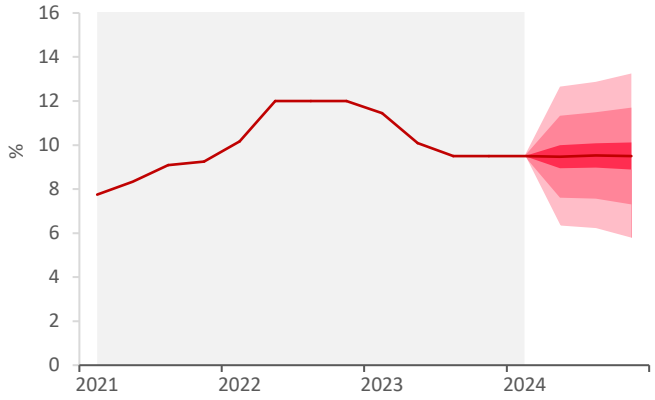
Nevertheless, the National Bank will use other tools to influence inflation processes amid increasing overheating of the Belarusian economy and price instability risks. It seems likely that prudential measures (estimated values of standard risk, credit limiters) and reserve requirements will be used, as well as a slow increase in the interest rates on overnight deposits if there are no heavy shocks. The consequence of this will be an increase in the interbank market rate, a higher profitability of bank deposits in Belarusian rubles, and a further rise in the cost of Belarusian ruble market lending. The average interest rate on Belarusian market ruble loans is projected at ≈10.7% in 2024 (Figure 10.b).

The stimulating effect of interest rates on economic activity will diminish in 2024, and the rates may get close to their neutral values in late 2024 (Figure 1)

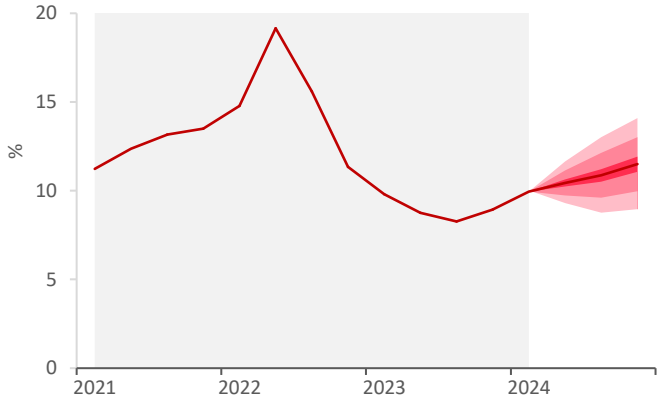
The transition of the monetary policy to moderate tightness after its extreme looseness in 2022—2023 is out of the question yet; however, that would be a healthy response to accumulating inflationary overhang and to overheating consumer demand.

Figure 10. Interest rate forecast (QPM-based)

a) refinancing rate (quarterly average)



b) average interest rate on Belarusian ruble market loans (quarterly average)



Source: The calculations are based on QPM.
Note: The ranges in the figure correspond to the 15%, 50% and 75% confidence intervals.

Foreign trade will increase its pressure on the foreign exchange rate in 2024

Excess demand in the economy will support high import volumes. Increased competition in the Russian market, infrastructure restrictions for further expanding the supplies of potassium and petroleum products to foreign markets, reached ceilings of industrial capacity utilization, continued sanctions pressure, and stagnation of the ICT sector will hamper exports.

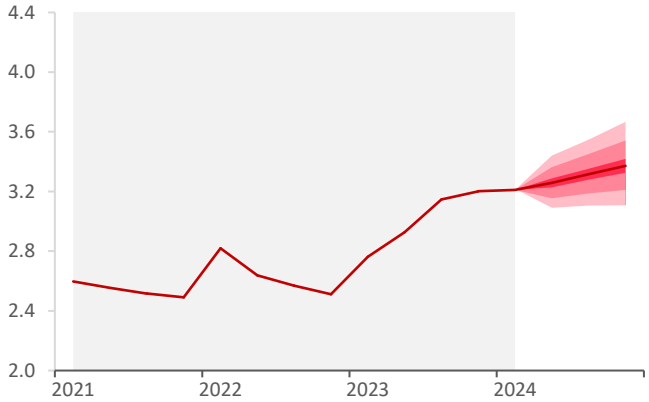
The price terms of trade will be affected by lowering prices for potash fertilizers on the global market, as well as by decreasing benefits for Belarus from the imports of cheap Russian Urals oil alongside its narrowing discount versus the Brent oil price. As a result, the state of foreign trade in goods and services could turn from a surplus of 0.7% of GDP in 2023 to a deficit of 0–1% of GDP in 2024, if there are not heavy shocks. This will pressure the Belarusian ruble exchange rate moderately.

The Belarusian ruble will weaken by 4–6% in terms of the foreign currency basket in 2024, given the projected dynamics of foreign trade and interest rates in the domestic and foreign markets

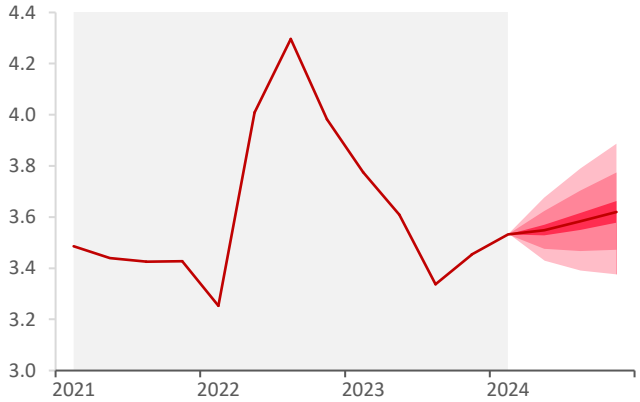
The dynamics of the Belarusian ruble exchange rates against individual foreign currencies will depend on the trajectory of cross exchange rates in foreign markets. If the USD/RUB rate is close to 92–93 Russian rubles per US dollar, the USD/BYN exchange rate will be 3.3 Belarusian rubles per US dollar on average in 2024 (Figure 11.a). In this case, the exchange rate of 100*RUB/BYN is projected at 3.6 Belarusian rubles per 100 Russian rubles on average in 2024 (Figure 11.b).

Figure 11. Belarusian ruble exchange rate forecast (QPM-based)

a) USD/BYN (quarterly average)



b) 100*RUB/BYN (quarterly average)



Source: The calculations are based on QPM.
Note: The ranges in the figure correspond to the 15%, 50% and 75% confidence intervals.

Deviation from the rules for conducting monetary policy causes extremely high uncertainty in forecasting monetary conditions

The National Bank is under pressure from the executive branch and does not have freedom of action. In this regard, if the Belarusian economy slows down, economic incentives, including monetary incentives, may strengthen in the second half of 2024 in an attempt to ensure the GDP growth target. If this scenario materializes, this will lead to shaping softer monetary conditions compared to the baseline forecast, and this is fraught with an increase in excess demand to 5–6% of potential GDP by late 2024. This will increase the threat of macroeconomic and financial destabilization if any significant external or internal shock occurs.

New significant sanctions and the threat of supply chain disruptions remain risk factors for the exchange rate dynamics: if they materialize, this will inevitably lead to a more significant depreciation of the Belarusian ruble (including against the Russian ruble) than assumed by the baseline scenario

Explainers

Quarterly Projection Model (QPM)

This is a semi-structural macroeconomic model based on the principles of new Keynesianism; it belongs to the class of dynamic stochastic general equilibrium models. Variables unobserved in the QPM (e.g., equilibrium (trendy) components of economic indicators) are estimated through the multivariate Kalman Filter. The QPM has been widely used for macroeconomic analysis, forecasting and monetary policy designs in central banks, including the National Bank of the Republic of Belarus.

QPM indicators

Monetary conditions

This is an indicator of the state of monetary conditions. It is a combination of gaps between the real effective exchange rate (with the opposite sign) and real interest rates. Positive values of monetary conditions indicate their constraining nature for economic activity, and their negative values indicate their stimulating nature for economic activity.

Output gap

This is a deviation of a real GDP from its potential value. A potential GDP is such a GDP value that leads neither to additional inflationary nor disinflationary pressures. A positive output gap indicates excess demand in the economy, and it is an indicator of inflationary pressure. The opposite is true for a negative output gap.

Interest rate gap

This is a deviation of the real interest rate from its neutral level. A positive gap in the interest rate indicates that the nature of the interest rate policy is restraining to economic activity, while a negative gap in the interest rate indicates that the nature of the interest rate policy is stimulating to economic activity.

Equilibrium (neutral) interest rate

This is the level of the real interest rate corresponding to the growth rate of the potential GDP and the equilibrium real effective exchange rate.

Real Effective Exchange Rate gap (REER gap)

This is a deviation of the real effective exchange rate of the Belarusian ruble from its equilibrium level. A positive real effective exchange rate gap indicates an undervaluation of the Belarusian ruble, while a negative real effective exchange rate gap indicates an overvaluation of the Belarusian ruble.

Equilibrium Real Effective Exchange Rate

This is the level of the Real Effective Exchange Rate (REER) that makes neither an additional pro-inflationary impact nor a disinflationary impact.

Notes

[i] Real interest rates are calculated by adjusting nominal rates for the projected annual inflation in the coming quarter estimated through the Quarterly Projection Model (QPM). Expert opinions were introduced into QPM in Q4-2022 and in Q1-Q3-2023 to correctly assess the deviation of real interest rates from their equilibrium (neutral) levels. This is because the introduction of a new price control system led to ad-hoc price reductions in Q4-2022, which significantly reduced rational inflation expectations estimated in QPM directly. Since rational expectations are used in the model to calculate real interest rates, their sharp decline has sharply increased the real interest rate estimates. Nonetheless, nominal interest rates on Belarusian ruble loans and deposits in the period under review rewrote their historical lows several times: lending was growing rapidly, and the share of "fast" money in the money supply structure reached its maximum for the first time in more than twenty years. To eliminate the ad-hoc impact of price declines on the estimates of the monetary conditions, the impact of the core inflation shock on the change in rational inflationary expectations in the period under review was evaluated and the estimates of the deviation of real interest rates from their equilibrium (neutral) levels were adjusted for the scale of this impact.

[ii] The X13 procedure in the JDemetra+ app was applied to make a seasonal adjustment. As new data are published, the indicator dynamics in previous periods can be updated. The annualized price increase is calculated as a seasonally adjusted price increase per quarter raised to the fourth power (an annual inflation equivalent).

[iii] The nominal average interest rate on new term Belarusian ruble deposits increased from 4.5% on average in Q4-2023 to 5.9% in Q1-2024, including interest rates on corporate deposits, which increased from 3.9% to 5.4%, and interest rates on retail deposits, which increased from 9.3% to 9.7%.

[iv] The nominal average interest rate on new market bank loans in Belarusian rubles increased from 8.9% on average in Q4-2023 to 10.0% in Q1-2024; in particular, interest rates on business loans decreased from 8.8% to 9.9%, and interest rates on retail loans remained at 10.0%.

[v] According to preliminary estimates, final consumption expenditures of households could increase by more than 3% in real terms in Q1-2024 versus Q4-2023 (seasonally adjusted). In March, retail trade volume (in real terms) was almost 14% above the 2021 average.