

Belarus Economy Monitor: trends, attitudes and expectations

Monetary Environment Review Q3-2023

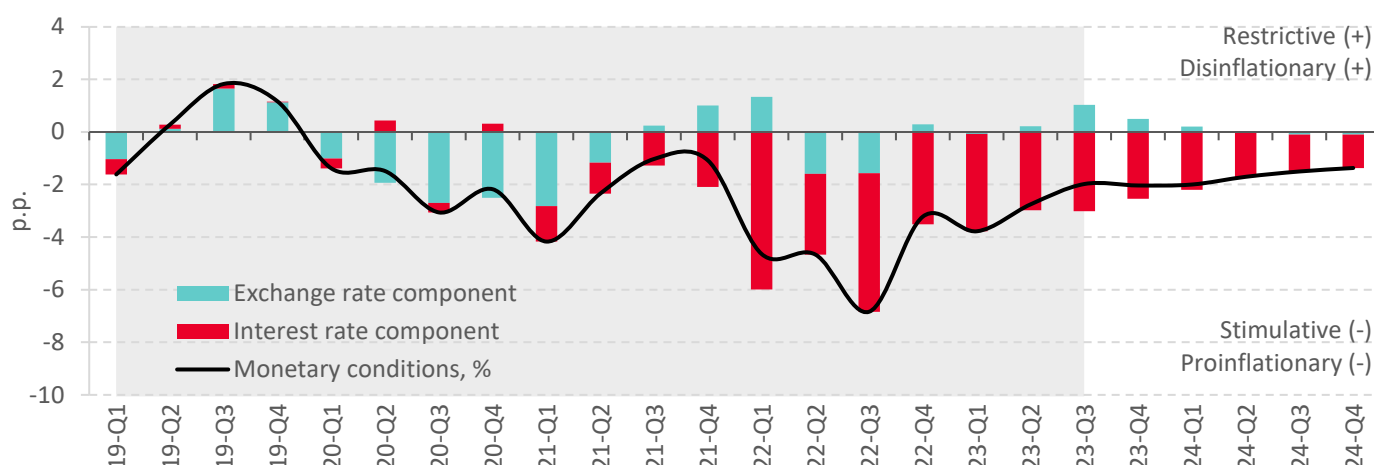
November 2023

Ensuring macroeconomic stability comes into increasing conflict with the ongoing monetary policy

Monetary conditions remained stimulating for economic activity in Q3-2023 (Figure 1). Loose monetary conditions were supported by low interest rates in the credit and deposit market, which remained below their neutral levels. Monetary stimulus became one of the drivers for GDP growth and widening of the positive output gap in Q3-2023. From the foreign exchange rate perspective, the impact on economic activity is assessed as weakly restraining in Q3-2023 due to the overvaluation of the Belarusian ruble.

The baseline scenario expects that loose monetary conditions and the National Bank's focus on supporting output will continue in 2024 (Figure 1). However, in order to prevent the growth of macroeconomic imbalances, it is advisable to move to the "normalization" of monetary policy in combination with the easing of price controls as early as 2023.

Figure 1. The nature of the monetary conditions of 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.

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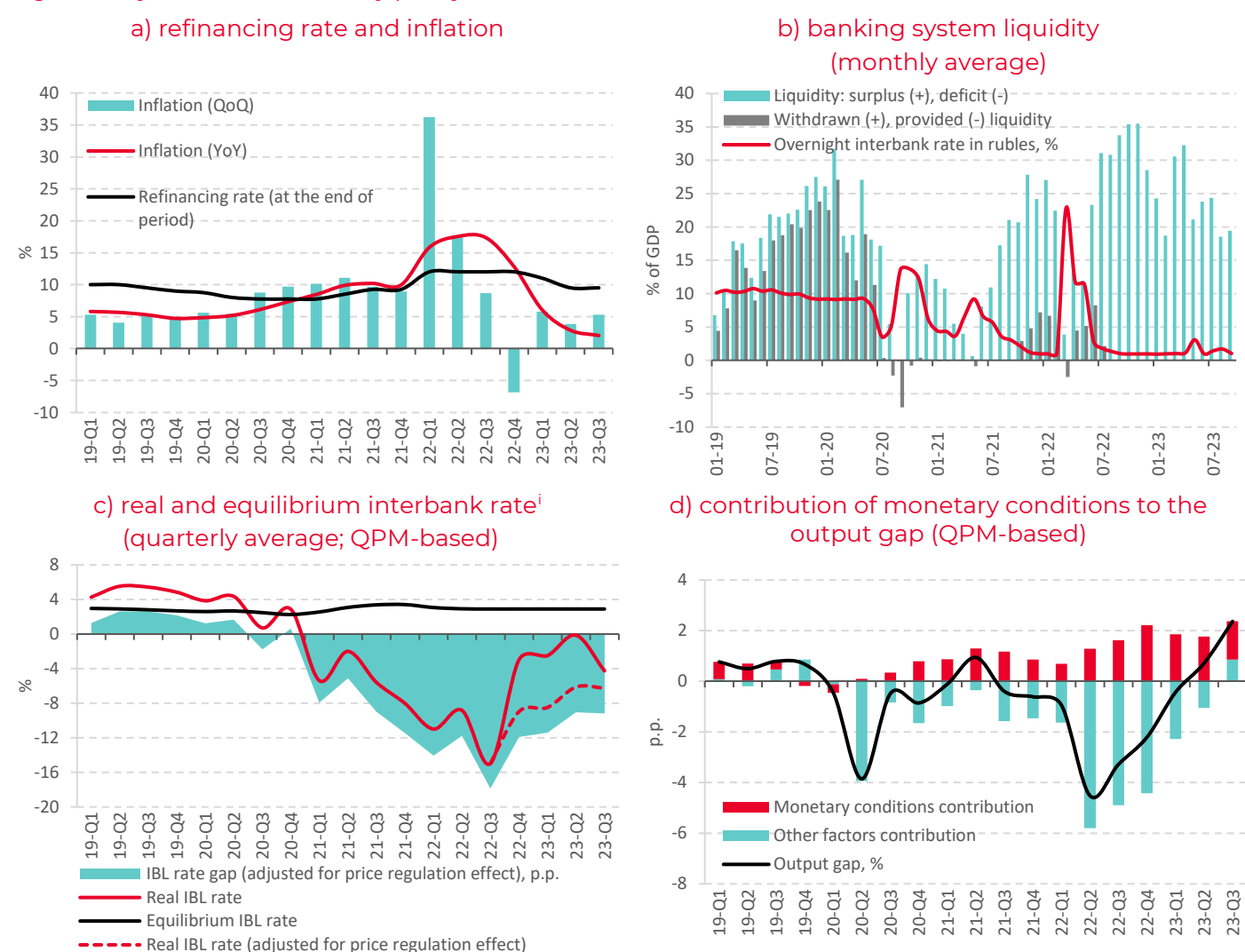
1 Monetary policy: measures, direction, nature

Monetary conditions continued stimulating economic activity in Q3-2023

In Q3-2023, the National Bank did not change the refinancing rate, which remained at 9.5% (Figure 2.a). The National Bank did not use market instruments for regulating the liquidity of the banking system, and it continued to operate in a state of a significant excessive and non-withdrawable — by the National Bank — liquidity (Figure 2.b).

Loose monetary policy remained one of the drivers for maintaining excess demand in the economy, which was expressed in the widening of the positive output gap (Figure 2.d). Given the rapid growth of wages in Belarus and the acceleration of price growth in Russia, the overheating of the Belarusian economy is increasing inflationary pressure and threats to macroeconomic stability.

Figure 2. Dynamics of monetary policy indicators



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. 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). Hereinafter, real rates are calculated by adjusting nominal rates for the projected annual inflation in the coming quarter estimated through the Quarterly Projection Model (QPM).

The ability of the National Bank to leverage monetary policy instruments to influence inflation — independently of the government — remains doubtful

Despite the statements made by the National Bank at the beginning of Q3-2023 that in the near future a more rapid reorientation of monetary policy might be required to maintain macroeconomic stability,ⁱⁱ there were no clear signs of such actions as of the beginning of November 2023, despite all greater deviation of demand from supply in the economy (Figure 2.d). Maintaining an excessively loose monetary policy in the current conditions comes into increasing conflict with the task of ensuring macroeconomic stability.

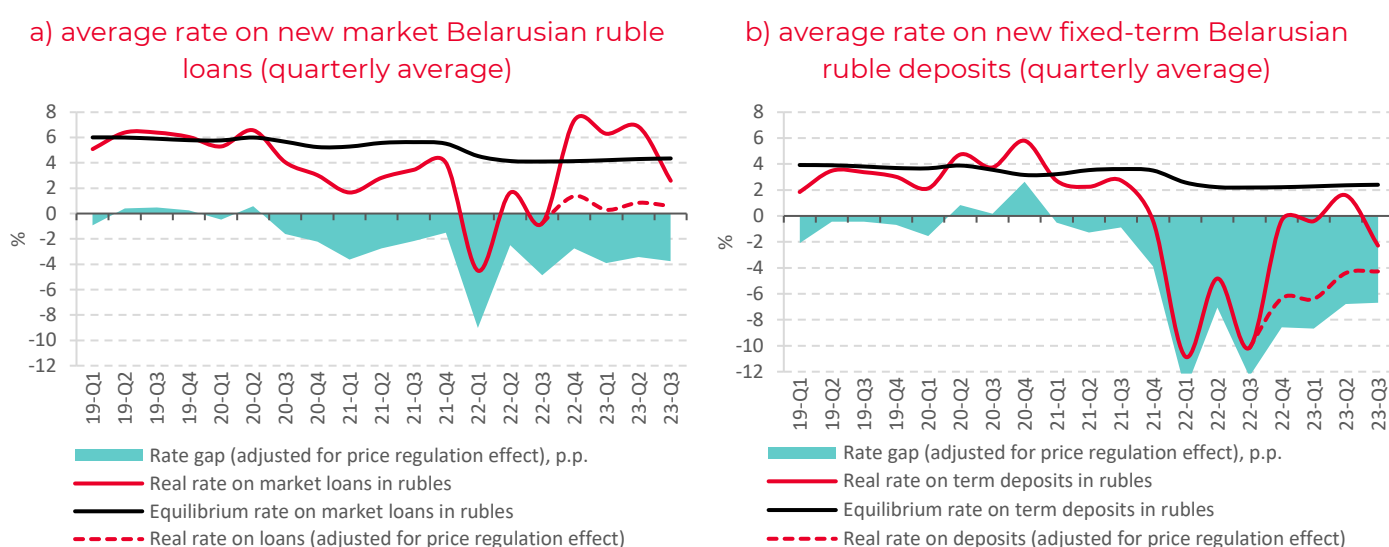
The overnight interbank market interest rate in Belarusian rubles (IBL) remained well below the inflation-neutral level

The average interbank lending rate was $\approx 1.4\%$ in nominal terms in Q3-2023. The low level of cost of resources in the interbank market is ensured by a significant structural liquidity surplus not withdrawn by the National Bank from the banking system (Figure 2.b). In real terms, the interbank lending rate remained negative: it was significantly below the equilibrium value estimated through QPM (Figure 2.c). The negative interest rate gap is maintained in the context of a positive output gap and increased inflation risks: monetary policy is pro-cyclical, and it contradicts its stabilization function. The degree of the deviation of the real interbank loan rate from its neutral level indicates excessive looseness of monetary policy in Q3-2023.

Interest rates on deposits are below equilibrium (neutral) values

The average nominal interest rate on new Belarusian ruble term deposits in Q3-2023 remained near its historically minimum values.ⁱⁱⁱ The rate size in real terms was not an additional incentive to deposit Belarusian rubles (Figure 3.b). At the same time, despite the persistence of a massive liquidity surplus, deposit interest rates, especially retail deposit rates, stopped decreasing amid growing inflation and devaluation risks.

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



Source: The calculations are based on QPM.

Note: Real interest rates in Figures 3.a and 3.b 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).

Interest rates on Belarusian ruble loans remained stimulating for economic activity

The nominal average rate on new market loans in Belarusian rubles decreased by 0.5 percentage points in Q3-2023.^{iv} In August, a historical minimum was recorded at 8.21%, but the rate decline stopped in September. It is possible that, against the backdrop of increasing threats to macroeconomic stability, the Belarusian ruble loan interest rates were near the turning point of the downward trend in late Q3-2023. In real terms, the rates remained below their neutral values, which stimulated credit and economic activity (Figure 3.a).

2 Exchange rate policy: measures, direction, nature

The Belarusian ruble strengthened on average in Q3-2023; however, the foreign exchange market moved to a state of net demand for foreign currency in August-September

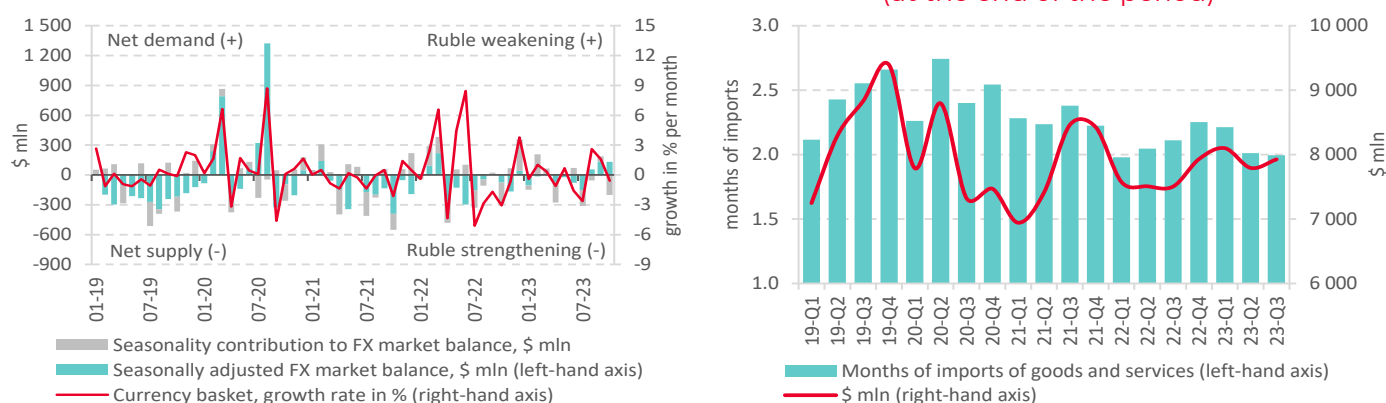
On average, the value of the basket of 3 foreign currencies (Russian ruble, US dollar, Chinese yuan) decreased by 2.4% in Q3-2023 versus Q2-2023. In terms of the nominal effective exchange rate, the Belarusian ruble appreciated by 4.7% over the same period (Figure 5.b). The Belarusian ruble strengthened strongly in June-July amid net supply of foreign currency in the domestic market. In August-September, the state of the foreign exchange market changed to net demand for foreign currency, which expressed in the weakening of the national currency in these months (Figure 4.a).

Foreign exchange rate fluctuations against individual foreign currencies were mainly determined by the dynamics of their cross rates in foreign markets: over Q3-2023 on average, the Belarusian ruble weakened by 7.3% against the US dollar and euro, by 3.5% against the yuan, while strengthening by 7.7% against the Russian ruble. The National Bank smoothed out the volatility of the exchange rate through its interventions: its purchase of foreign currency (together with the Ministry of Finance) amounted to \$122 million in Q3-2023. At the same time, direct net foreign currency purchase by the National Bank was observed only in July (~\$300 million), while in August and September, the National Bank sold foreign currency (~\$10 and 190 million, respectively) to prevent a steep weakening of the Belarusian ruble (Figure 4.a).

Figure 4. Dynamics of the foreign currencies basket and of gold and foreign exchange reserves

a) forex market and foreign currencies basket

b) gold and foreign exchange reserves
(at the end of the period)



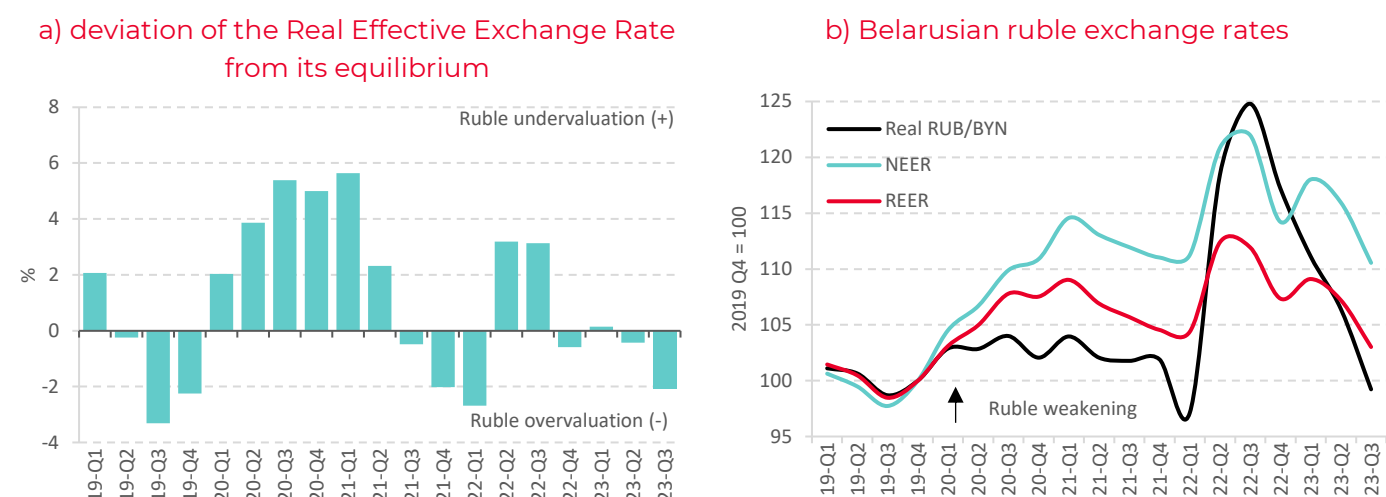
Source: The calculations are based on the data by the National Bank of Belarus.

Note: Figure 4.a shows 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 in JDemetra+ was applied to make a seasonal adjustment. The indicator dynamics updates once new data are published.

In Q3-2023, the Belarusian ruble was overvalued versus the equilibrium real effective exchange rate

Significant strengthening of the Belarusian ruble against the Russian ruble resulted in the overvaluation of the Belarusian ruble (Figure 5.a). This helped limit the pro-inflationary consequences of accelerating price growth in Russia for the Belarusian market. At the same time, the competitive advantages of Belarusian manufacturers in the Russian market continued weakening. The impact of the overvalued Belarusian ruble on exports was not pronounced in Q3-2023 largely due to the continued high demand from the Russian military-industrial complex and the operation of adjusted supply schemes for potash fertilizers and petroleum products channeled through Russia.

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



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 (IRA) increased by \$133.5 million in Q3-2023

The factor behind the increase in reserves was the increase in the Government's foreign currency deposits in the National Bank by \$187.4 million in Q3-2023. It is quite possible that amid the repayment schemes for external obligations in Belarusian rubles and increased tax revenues, budget foreign currency revenues from export duties (mainly associated with the supply of potash fertilizers) are accumulated in the bank accounts of the Government. The dynamics of gold and foreign exchange reserves in Q3-2023 was affected by the decrease in the value of monetary gold due to lower world market prices and the revaluation of SDRs. Despite the growth of reserves in absolute terms, their size relative to imports of goods and services dropped to 2 months by the end of Q3-2023 (Figure 4.b): the adequacy of reserves remained low.

The foreign exchange market was in a state of net demand for foreign currency (seasonally adjusted) in August-October

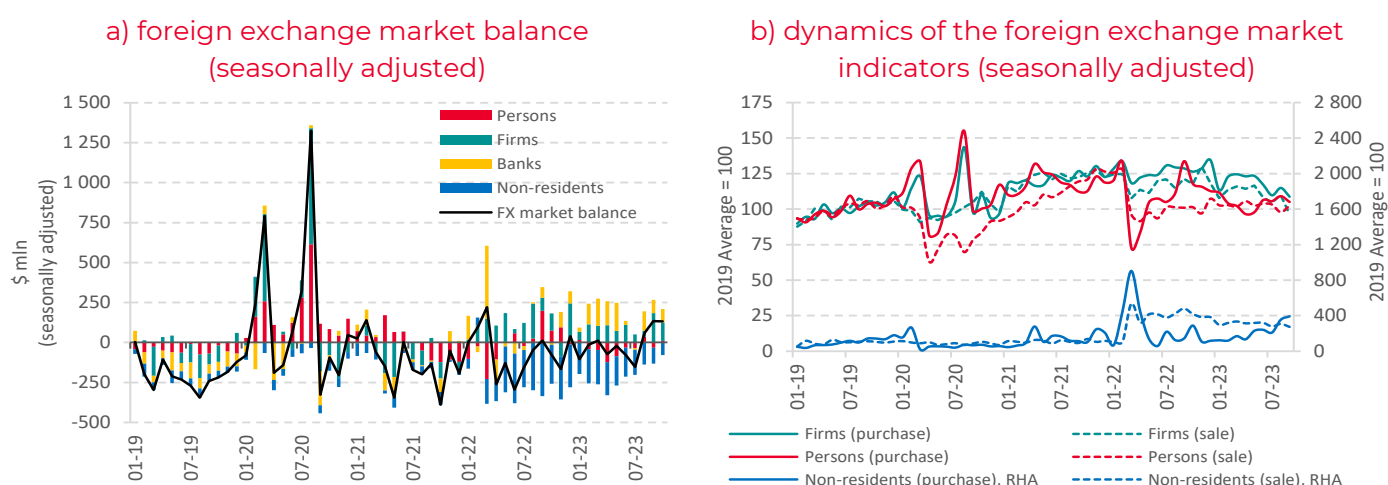
The change in the state of the foreign exchange market was largely a consequence of a decrease in the net supply of foreign currency by non-residents, who acted as its donor (Figure 6.a). Non-residents noticeably increased foreign currency purchases in August-October (Figure 6.b), which could be associated with capital outflow (including the effects of repaying foreign currency liabilities in Belarusian rubles). The sale of foreign currency by non-residents also decreased compared to last year (Figure 6.b).

One should not exclude the impact of the deteriorating state of foreign trade (since settlements in foreign trade transactions under sanctions can be done through intermediaries), as well as a narrowing spread between the buying and selling rates of Russian rubles in Belarusian banks.

The net sale of foreign currency (seasonally adjusted) by individuals also decreased in Q3-2023 (Figure 6.a). The growth of household incomes and the increase in Belarusian ruble lending so far largely support high consumer demand rather than translate into a significant increase in the purchase of foreign currency by individuals (Figure 6.b). At the same time, in the context of satisfying the demand for goods deferred during the shock of 2022, stimulating the growth of household incomes and maintaining loose lending conditions increase the risks of individuals switching to net purchases of foreign currency.

Stable net demand for foreign currency was sustained by firms and banks in Q3-2023 (Figure 7.a). It is supported by the process of changes in the currency of firms' liabilities on bank loans, as well as the deterioration in the state of foreign trade in goods and services, which became negative in Q3-2023 (seasonally adjusted). Excessive domestic demand in the context of large-scale monetary and fiscal stimulus is reflected in the trade deficit in goods, which, unlike the period 2017–2019, is not compensated by the surplus in trade in services, which has noticeably narrowed due to the decline in the ICT and transport sectors and due to the rise in logistics costs.

Figure 6. State of the domestic foreign exchange market



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

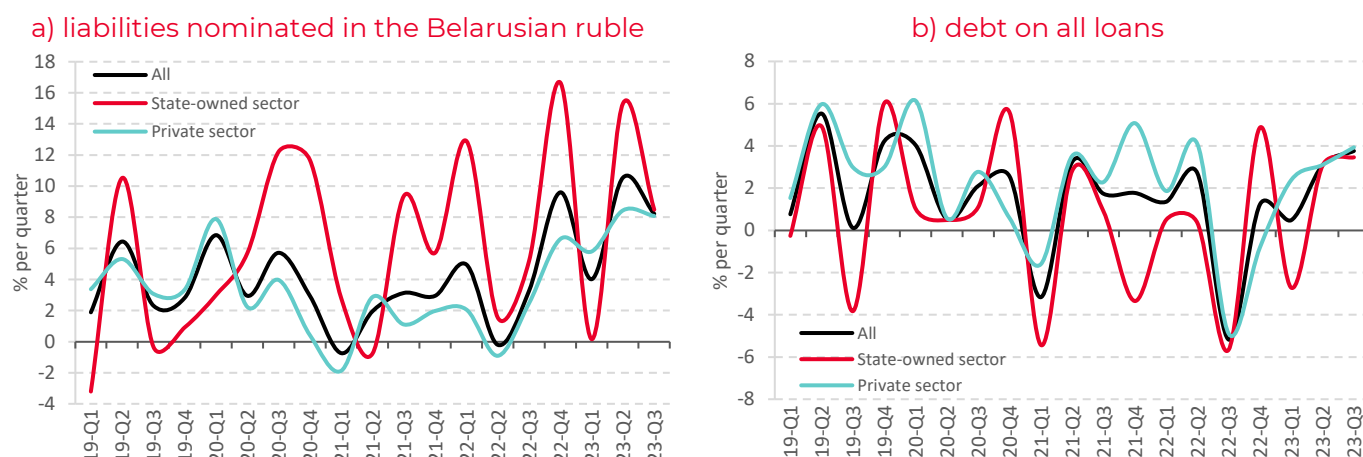
Note: The X13 procedure in the JDemetra+ app has been applied to make a seasonal adjustment. As new data are published, the dynamics of the indicators for the previous periods is updated.

3 Impact of monetary conditions on the credit and deposit market

Lending activity remained high in Q3-2023

The total volume of Belarusian ruble and foreign currency loans issued in Q3-2023 remained near the peak level of the previous quarter: approximately 47% higher than the quarterly average in 2021, and 33% higher than in 2022 (Figure 8.a). At the same time, credit impulse (which measures the change in the ratio of newly issued loans to GDP) turned out to be negative in Q3-2023 (Figure 8.b). This may indicate that loose monetary conditions continued to support strong lending activity; however, as output growth is difficult to grow rapidly in an overheated environment, expansion in demand for new loans has slowed. It also cannot be ruled out that the weakening of the credit impulse may be of a corrective nature, and in the context of stimulating monetary policy, its size will recover in the following quarters.

Figure 7. Dynamics of bank loan investments (quarterly growth, seasonality adjusted)



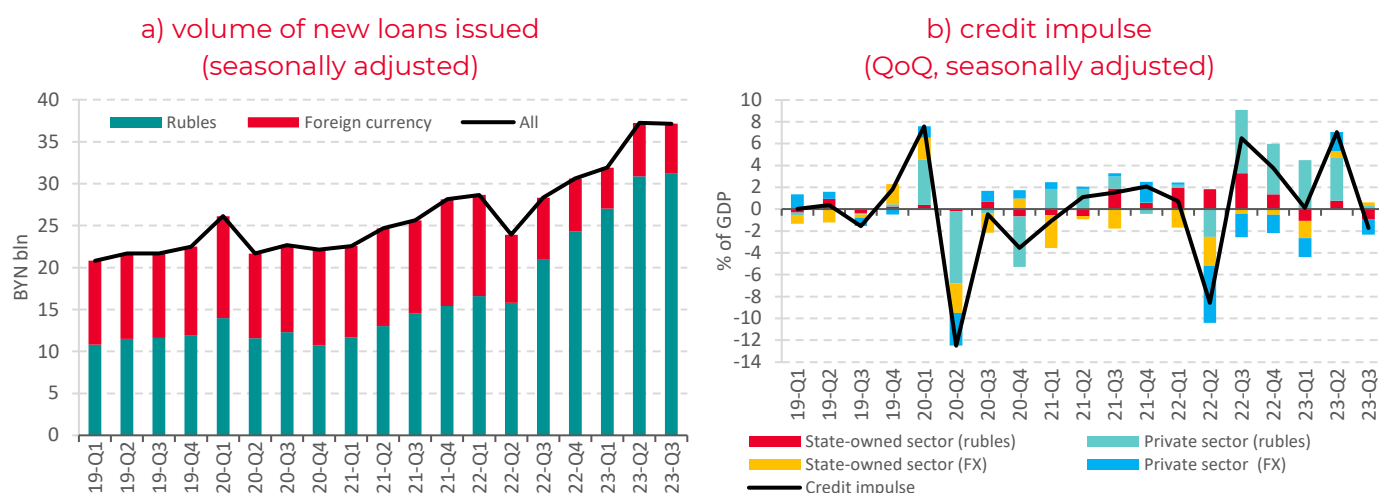
Source: The calculations are based on the data by the National Bank of Belarus.

Note: The X13 procedure in the JDemetra+ app has been applied to make a seasonal adjustment. The indicator dynamics updates once new data are published. In Figure 7.b, the Belarusian ruble equivalent of foreign currency loans is calculated at the fixed average USD/BYN rate for 2022.

Loan debt grew at a high pace amid continued significant volumes of new borrowings

In Q3-2023, the growth rate of credit debt remained high both in state-owned enterprises and in the private sector, including in the private business and household segments (Figure 7). Lending activity in an environment of stimulating monetary policy became one of the most important factors in ensuring high growth rates of the Belarusian economy in Q3-2023 and in expanding the positive output gap (Figure 2.d). Since the effects of the expansion of borrowing on the demand and output of goods and services are extended over time, the echoes of the noticeably increased lending activity this year will persist for several quarters.

Figure 8. Dynamics of new loans issued and credit impulse



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

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.

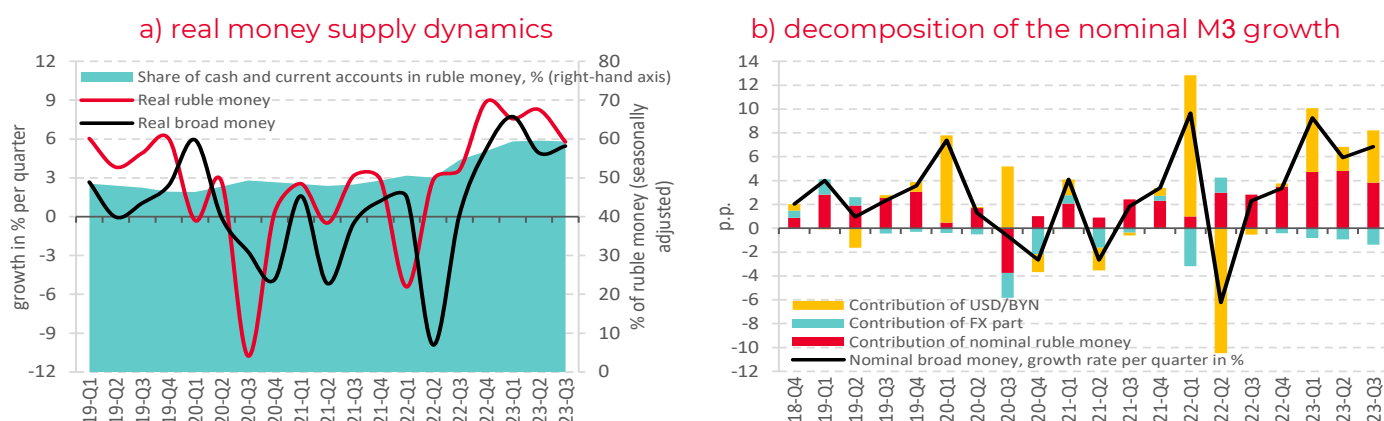
High lending activity supported rapid money supply growth (Figure 9.a)

Broad money supply (M3) increased by $\approx 6.8\%$ in nominal terms or by $\approx 5.5\%$ in real terms in September 2023 versus June 2023 (all indicators are seasonally adjusted). In an environment of loose monetary conditions, money supply continued to grow at a pace that significantly exceeds an inflation-neutral pace (which corresponds to changes in potential GDP and the equilibrium velocity of money). This resulted in an increase in the deviation of the volume of real broad money supply from the inflation-neutral level, which could get close to 10% in Q3-2023. This is one of the signs of the shaping inflationary overhang in the economy.

M3 growth continued to be driven by the growth of the Belarusian ruble component (Figure 9.b)

In Q3-2023, the Ruble Money Supply (M2*) grew by $\approx 7.2\%$ in nominal terms or by $\approx 5.8\%$ in real terms (Figure 9.a). The rapid increase in M2* is ensured by maintaining high growth rates of the Belarusian ruble credit debt. In the M2* structure, the share of cash and current accounts in Q3-2023 remained near their twenty-year highs of about 59% (Figure 9.a). Excessively loose monetary conditions weaken the stability of money supply in the face of crisis events.

Figure 9. Average money supply dynamics (seasonally adjusted)



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

Note: M3 is a broad money supply. The X13 procedure in the JDemetra+ app was applied to make a seasonal adjustment. The indicator dynamics updates once new data are published. The real money supply growth has been calculated by deflating the nominal increase (the last month of the quarter versus the last month of the previous quarter) by the quarterly change (seasonally adjusted) in the Consumer Price Index.

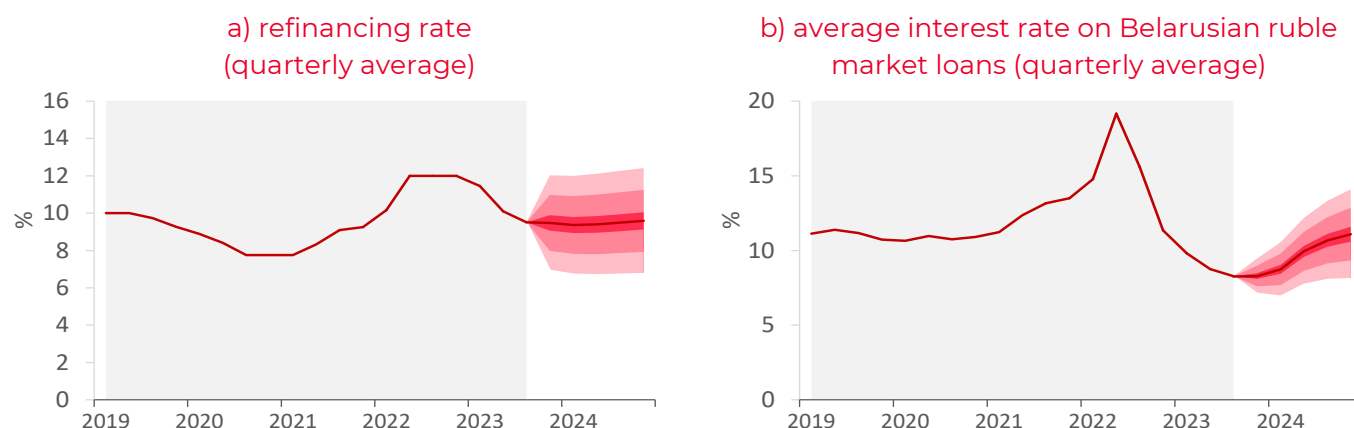
4 Monetary conditions short-term forecast

Monetary conditions will remain loose in 2024 (Figure 1)

Under government pressure, the National Bank will continue focusing on supporting economic activity, and inflation risks will be of secondary importance. The National Bank's ability to use the refinancing rate to regulate inflation processes is limited. If inflation does not exceed 10% (YoY) in 2024 (as assumed by the baseline scenario), the refinancing rate will most likely not increase, and it will stay close to 9.5% (Figure 10.a).

The expected use of emission financing for investment projects will be an additional factor supporting loose monetary conditions in 2024. At the same time, the National Bank is expected to use indirect levers to limit the growth rate of credit due to the inflation threat relevance. These tools could include raising reserve requirements, tightening prudential regulations, and, less likely, returning of the National Bank to actively regulated liquidity in the banking system.

Figure 10. Interest rate forecast (QPM-based)



Source: The calculations are based on QPM.

Note: The ranges in the figure correspond to the 15%, 50% and 75% confidence intervals.

Average interest rates on market loans in Belarusian rubles will increase in 2023, but they will continue stimulating economic activity

The average cost of market Belarusian ruble credit resources will be $\approx 10.1\%$ in 2024 (Figure 10.b). This assumes an increase in lending costs compared to 2023. In the context of growing risks to macroeconomic and financial stability, banks will have incentives to increase the cost of loans and, probably, to ration them due to the diversion of resources for lending under government programs. The nominal yield of Belarusian ruble deposits will also grow in 2024 as inflation accelerates. As a result, interest rates on market loans and time deposits in Belarusian rubles will continue stimulating economic activity, but the scale of the stimulus will get smaller (Figure 1).

Ensuring macroeconomic stability comes into increasing conflict with the authorities goals

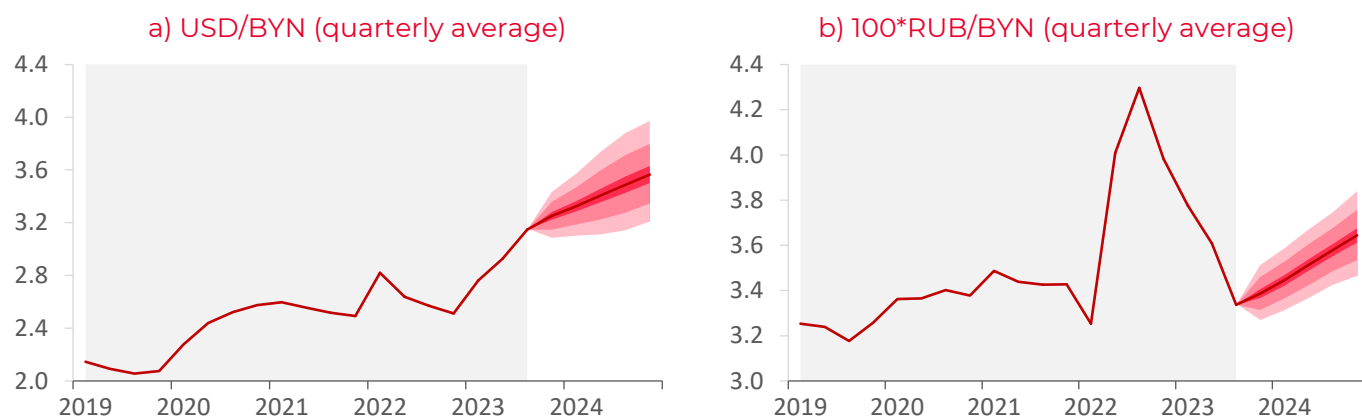
In the baseline scenario, inflation is projected to accelerate to 8–10% in 2024 due to the effects of overly-stimulating monetary and fiscal policies. Due to the time lag between the adoption of monetary policy measures and their maximum effects on prices, achieving the 6% inflation target in 2024 without policy interventions of the authorities seems challenging even if monetary tightening begins at the end of 2023. Due to accumulated macroeconomic imbalances, “bringing down” inflationary pressure may require a sharp and large-scale tightening of monetary policy, which will be painful for the economy and, most likely, unacceptable for the authorities. At the same time, in order to prevent the expansion of imbalances, it makes sense to move to a gradual “normalization” of monetary policy in combination with easing price regulation as early as 2023.

Deterioration of foreign trade creates conditions for the Belarusian ruble to weaken in 2024

The baseline forecast scenario assumes that in an environment of maintaining stimulating domestic economic policies, the Belarusian economy will continue to operate in a state of excess demand in 2024: GDP growth will slow down significantly due to weakened growth prospects in an overheated economy, but GDP will remain above its equilibrium level (the output gap will remain positive). Given the projected weakening of Russian economic growth, this will be reflected in an increasing foreign trade deficit, and this will support net corporate demand for foreign currency. The transactions of non-residents are expected to continue the trend towards “normalization” of net sales of foreign currency, which shaped in the summer of 2023. The net supply of foreign currency from households may decrease in 2024 compared to 2023 against the backdrop of significantly increased wages and the expected acceleration of inflation processes.

As a result, the Belarusian ruble has the prerequisites for weakening in 2024. If there are no additional shocks (largely related to non-economic risks), the rate of weakening is expected to be moderate: about 8–9% in terms of a foreign currencies basket (Q4-2024 versus Q4-2023). This will allow the real effective exchange rate to return to its equilibrium trajectory: the overvaluation of the Belarusian ruble will be neutralized (Figure 1). The dynamics of the Belarusian ruble exchange rates against individual foreign currencies will depend on the trajectory of cross rates in foreign markets (Figure 11).

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



Source: The calculations are based on QPM.

Note: The ranges in the figure correspond to the 15%, 50% and 75% confidence intervals.

Devaluation risks for foreign exchange rate dynamics remain high, and they originate from both domestic economic policy and the external environment

Given the expected slowdown in economic growth, one cannot rule out increased monetary and/or fiscal stimulus combined with the preservation of blanket price controls in the authorities' attempts to mask structural flaws in the economic model. If the events develop this way, the pressure on the Belarusian ruble will increase, which may result in its significant weakening associated with the spending of gold and foreign exchange reserves.

New significant sanctions and supply chain disruptions may lead to a more significant depreciation of the Belarusian ruble, including its depreciation against the Russian ruble

Such depreciation may become the only available option to maintain competitiveness and to keep the level of current account deficit that can be financed in the context of limited access to external finance. If the situation develops as described above, the likelihood of an inflationary-devaluation spiral and full-scale financial destabilization increases.

The threat of stronger negative effects of fiscal stimulus on price stability in Russia and the Russian ruble exchange rates than assumed by the baseline scenario appears to be quite significant. If this risk materializes, this will lead to a larger price pressure in Belarus and to weakening of the Belarusian ruble.

Positive risks for the Belarusian ruble exchange rate remain the full recovery of exports of key goods (fertilizers, petroleum products, wood products) and stronger growth of the Russian economy (stronger than projected in 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 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 For details see: https://www.nbrb.by/top/pdf/doklad_murin_27-07-2023.pdf.

ⁱⁱⁱ The nominal average rate on new term Belarusian ruble deposits decreased from 3.5% on average in Q2-2023 to 3.4% in Q3-2023, including interest rates on corporate deposits, which decreased from 2.5% to 2.4%, and interest rates on retail deposits, which increased from 8.4% to 8.6%.

^{iv} The nominal average rate on new market bank loans in Belarusian rubles decreased from 8.8% on average in Q2-2023 to 8.3% in Q3-2023; in particular, interest rates on business loans decreased from 8.5% to 8.0%, and interest rates on retail loans decreased from 10.6% to 10.3%.