Belarus Economy Monitor:
trends, attitudes and expectations

Inflation Review
Q1-2024

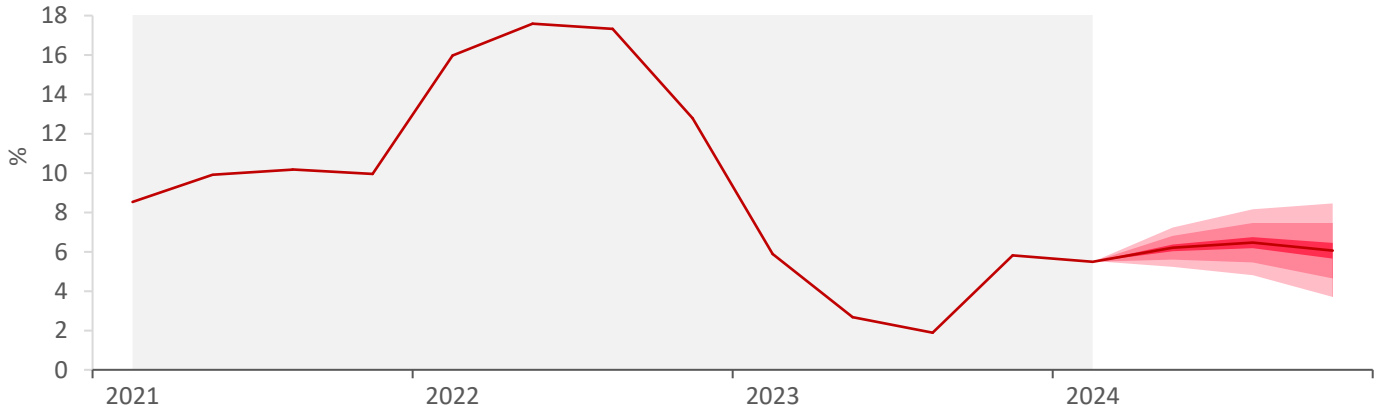
April 2024

"Schrödinger's inflation" poses threats to the macroeconomic stability of Belarus in the medium term

Annual inflation fell from 5.8% YoY in December 2023 to 5.6% YoY in March 2024, and annualized quarterly price growth (seasonally adjusted) fell from 8.5% QoQ in Q4-2023 to 4.9% QoQ in Q1-2024. The slowdown in inflation occurred in an environment of blanket price control, the authorities' conservative approach to increasing regulated prices, and lowering prices of fruits and vegetables. At the same time, increased inflationary pressure remained due to higher costs in the context of excess demand in the economy and a shortage of workers.

Inflation could be in the range of 5–7% YoY by the end of 2024 if prices remain inflexible to changes in market conditions due to strict price controls (Figure 1). The flip side of the excessive use of administrative tools will be an increased threat of growing commodity deficits and an expansion of the inflationary overhang, which could reach at least 6% by the end of Q1-2024. In such an environment, any significant internal or external inflation shock will significantly limit the authorities' ability to leverage price controls.

Figure 1. Dynamics and forecast of consumer inflation in Belarus, % (YoY)



Source: The calculations are based on the Quarterly Projection Model (QPM) for Belarus.
Note: The figure shows a seasonally adjusted indicator. The X13 procedure in the JDemetra+ app was applied to make a seasonal adjustment. As new data are published, the indicator dynamics can be updated. The ranges in the figure correspond to the 15%, 50% and 75% confidence intervals.

The Inflation Review Bulletin is an expert analysis of inflationary processes in the consumer market. The bulletin depicts the dynamics of price indices, analyzes the drivers of inflationary processes, assesses the nature of monetary conditions, and provides a short-term inflation forecast. The methodological basis for the analysis is the Quarterly Projection Model (QPM) for Belarus.

1 Dynamics of inflationary processes

Inflation slowed in Q1-2024

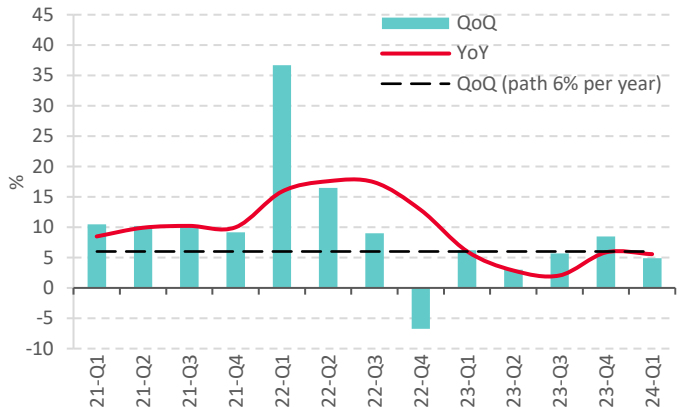
In Q1-2024, consumer prices grew by 4.9% in annualized terms (seasonally adjusted) following an 8.5% growth in Q4-2023 (hereinafter, % QoQ).[i] Annual inflation (under the Consumer Price Index (CPI)) decreased from 5.84% in December 2023 to 5.55% in March 2024 (hereinafter, % YoY; Figure 2.a). Annual inflation deviated by ≈0.4 percentage points down from the January 2024 forecast. The deviation is explained by a sharp decline in extremely volatile prices for fruits and vegetables in Q1-2024 after their rapid growth in the second half of 2023, as well as a greater-than-predicted restraining effect of price controls on inflation (Figure 2.c).

Inflation slowdown in Q1-2024 is associated with a sharp weakening in the dynamics of its non-core component

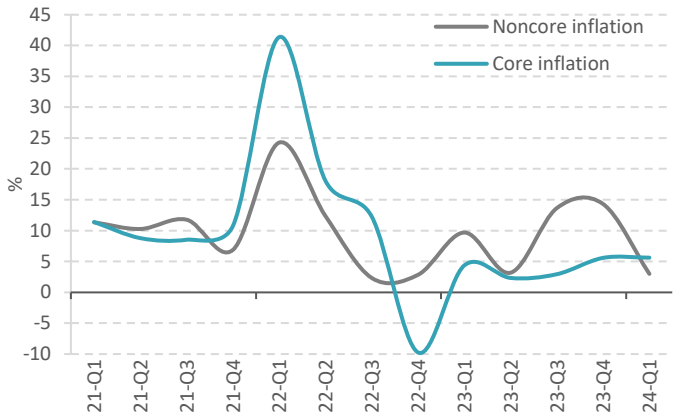
Non-core inflation is estimated at 3% QoQ in Q1-2024 following its value of ≈14% QoQ in the second half of 2023 (Figure 2.b). The cost of vegetables and fruits (seasonally adjusted) decreased at the beginning of the year, and the increase in regulated prices slowed down by more than half — to less than 5% QoQ — in the context of the authorities' conservative approach to price increase.

Figure 2. Dynamics of consumer inflation

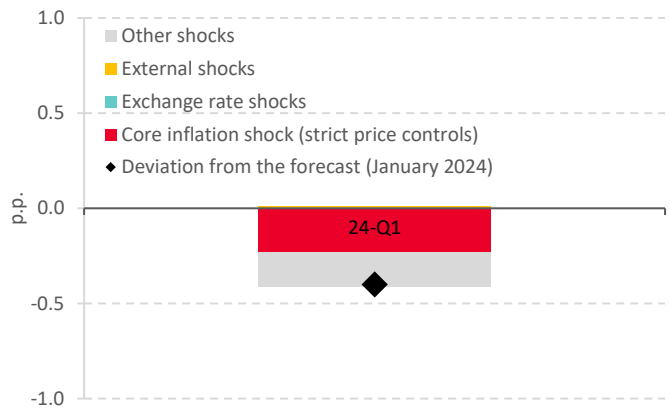
a) overall inflation



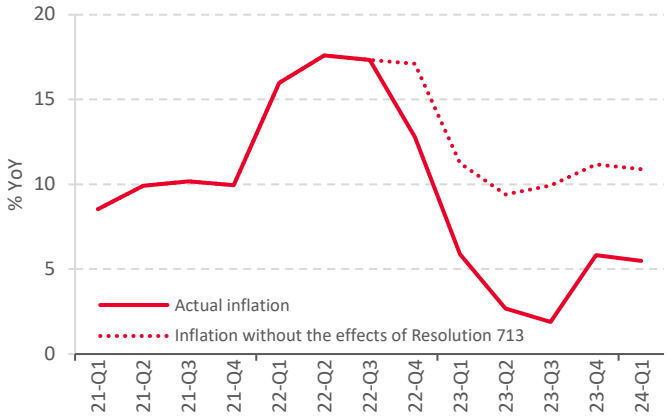
b) core and non-core inflation



c) factors of deviation of annual consolidated inflation from the January 2024 forecast



d) impact of the updated (in October 2022) price control system on inflation[ii]



Source: The calculations based on the data from Belstat, QPM.

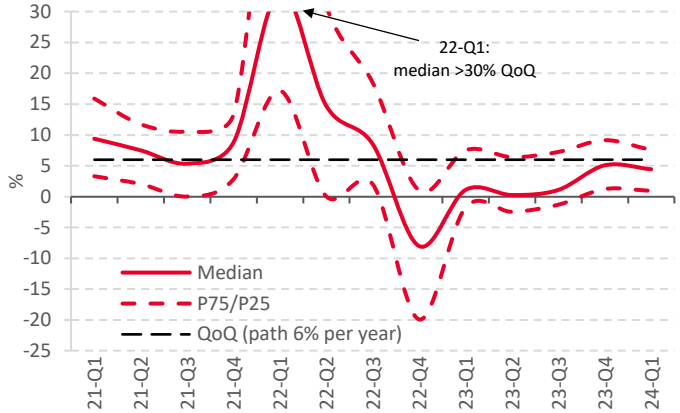
Note: Hereinafter, YoY is the growth rate in the last month of the quarter versus the last month of the corresponding quarter of the previous year; QoQ is the annualized growth rate in the last month of the quarter versus the last month of the previous quarter, seasonally adjusted.

Core inflation in Q1-2024 remained at the level of the previous quarter (5.6% QoQ), and the median inflation fell to 4.4% QoQ (Figure 2.b; Figure 3.a)

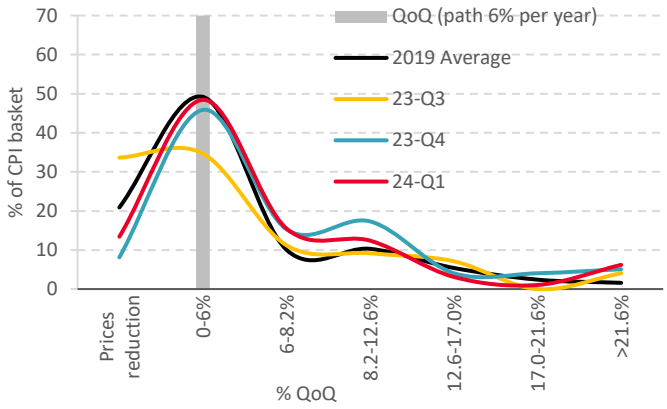
The distribution of price changes in the consumer basket has approached the pattern of 2019 (Figure 3.b), when inflation was stable and around 5% YoY. However, unlike 2019, the Belarusian economy at the beginning of 2024 operates in an environment of excess demand and record capacity utilization; labor costs grow at a high rate, and price pressure in Russia is noticeably stronger. Combined with the communication policy of the National Bank, which has degraded since then, this gives reason to believe that, de facto, the only reason for containing core and median inflation at the beginning of 2024 was blanket price control.

Figure 3. Dynamics of median inflation and distribution of relative price growth

a) median inflation (QoQ)



b) price increment distribution (QoQ)



Source: The calculations based on the Belstat data.

Note: Median inflation and price increment distribution are calculated using data from aggregated commodities in the CPI basket. P75 and P25 are the 75th and 25th percentiles, respectively (prices for 25% of goods rise faster than the inflation of the 75th percentile, and prices for another 25% of goods rise slower than the inflation of the 25th percentile).

In Q1-2024, price growth slowed down in all components of the consumer basket, and most significantly in prices for food products

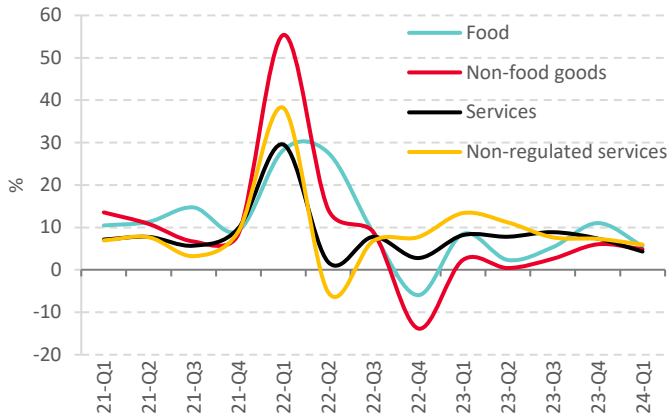
Food inflation in Q1-2024 slowed down by half compared to the previous quarter, to 5.6% QoQ (Figure 4.a). Median inflation in this segment fell to 4.3% QoQ, and seasonally adjusted quarterly price growth slowed in 19 of 28 consolidated items. The decisive contribution to the slowdown in food inflation was made by lower prices of fruits and vegetables (Figure 5.a); this was observed against the backdrop of a significant increase in the share of sales of Belarusian cucumbers in retail chains. It cannot be ruled out that this was possible because of the expanded gas subsidies for Belarus from Russia in 2023 and in early 2024 compared to 2022. Prices for tobacco and alcohol products continued growing in Q1-2024 due to higher excise taxes (Figure 5.a).

Inflation in the non-food segment remained subdued by price controls and is estimated at 4.9% QoQ in Q1-2024

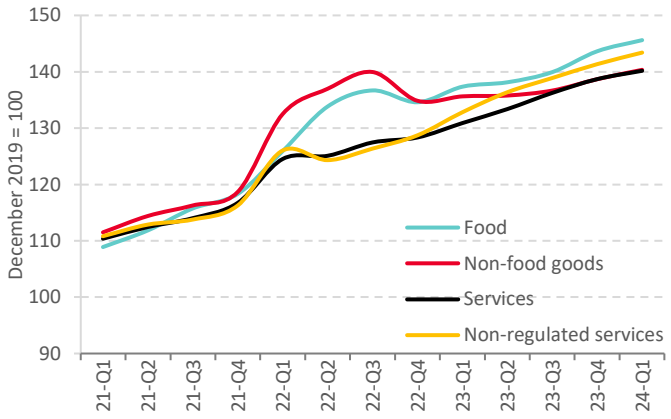
The median growth in prices for non-food products decreased from 4.8% QoQ Q4-2023 to 3.5% QoQ in Q1-2024. A significant contribution to the slowdown in non-food inflation was made by the reduction in prices of cars, which may be temporary due to an increase in recycling fees effective from Q2-2024. Higher inflation persisted in cosmetics and cleaning agents, household chemical products and medicines (Figure 5.b), which may reflect the impact of the weakening Belarusian ruble in Q4-2023 and in Q1-2024.

Figure 4. Dynamics of inflation and prices of aggregated CPI components (seasonally adjusted)

a) QoQ



b) December 2019 = 100



Source: The calculations based on the Belstat data.

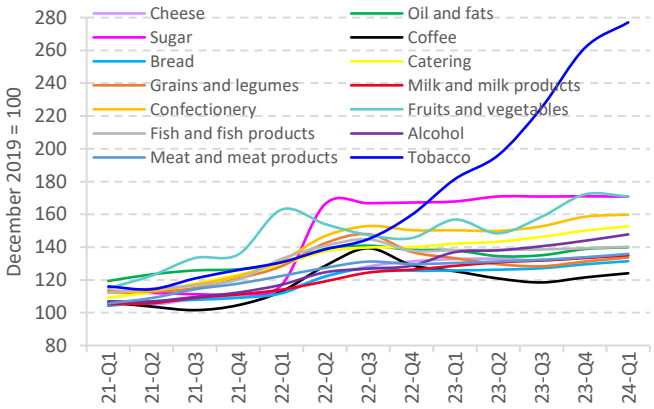
Note: QoQ (quarter-on-quarter) is the annualized growth rate in the last month of the quarter vs the last month of the previous quarter, seasonally adjusted.

Inflation in the services segment has slowed significantly due to administratively regulated and volatile items

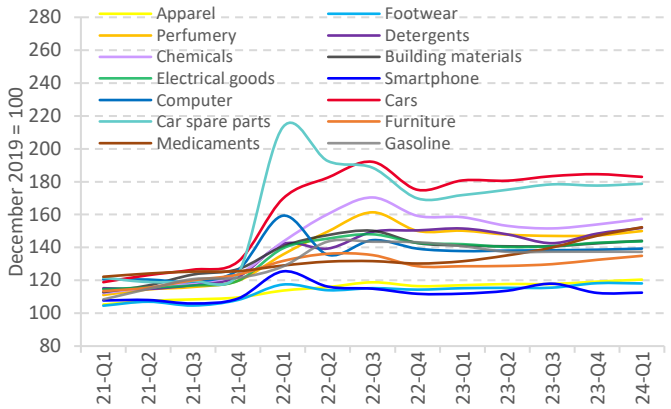
Service inflation is estimated at 4.3% QoQ in Q1-2024 (Figure 4.a). The increase in regulated prices and tariffs at the beginning of the year was restrained (Figure 5.c); this was probably due to the authorities' intention to limit inflation to 4–5% this year. Weak price dynamics were also observed in transportation by rail and air, which was the main reason for the inflation slowdown in unregulated services to ≈6% QoQ in Q1-2024 (Figure 4.a). At the same time, market services continue to rise in price faster than other items in the consumer basket, and the cost of services with a high share of labor in costs (in-home services, cultural and sports services, medical services, unregulated utility services, training services) continued to grow at a high pace (Figure 5.c). As a result, the price level for unregulated services continues to significantly exceed the price level for all services and non-food products (Figure 4.b), which emphasizes the high likelihood of a significant inflationary overhang.

Figure 5. Price dynamics for individual consumer basket items (seasonally adjusted)

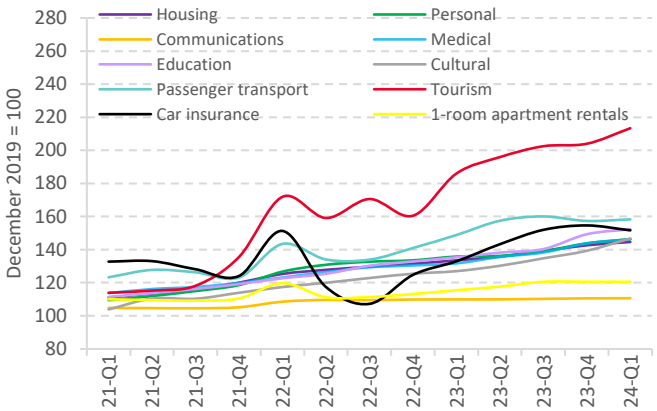
a) food prices



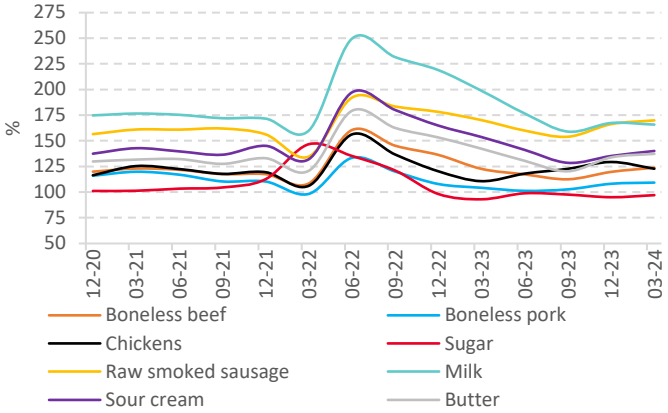
b) non-food prices



c) service prices



d) price ratio in Russia and Belarus



Source: The calculations are based on the data by Belstat, the National Bank of Belarus, and Rosstat.
Note: The ratio of prices in Russia and Belarus has been calculated as the ratio of the average price in Russia — recalculated at the average official foreign exchange rate of the Belarusian ruble to the Russian ruble — to the average price of goods in Belarus, multiplied by 100.

2 Inflation drivers

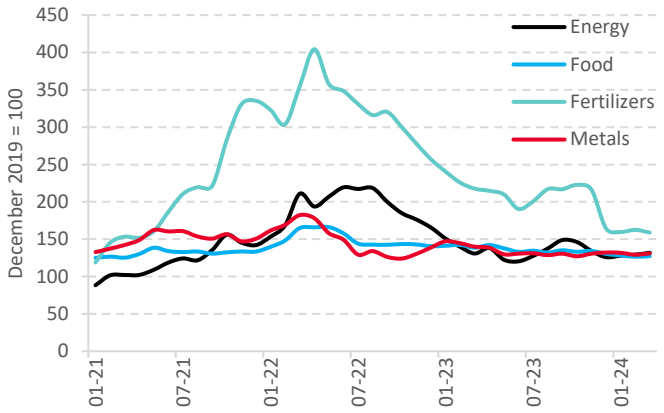
There was no pressure on domestic prices from the commodity market in Q1-2024

The World Bank US dollar Commodity Price Index (CPI) lowered by 3.1% in Q1-2024 versus Q4-2023. Prices for both energy commodities and non-energy goods decreased slightly (Figure 6.a). Sea container shipments became more expensive at the beginning of this year due to the aggravation of the situation in the Red Sea, but shipment costs remained much lower than in 2021–2022. Overall, no additional pressure was observed in global supply chains in Q1-2024 (Figure 6.b).

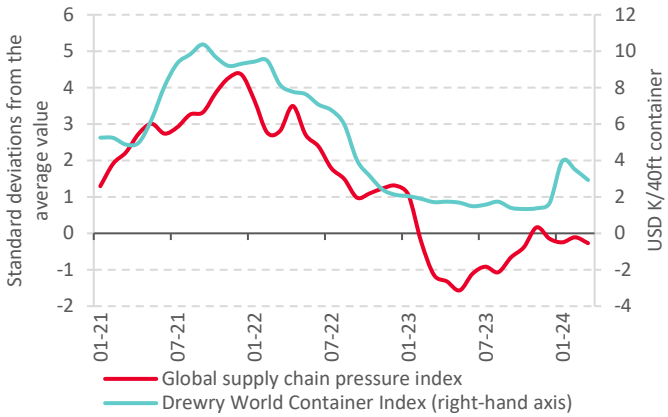
Lacking pro-inflationary impact of the commodity market facilitated a slowdown in global consumer price growth in Q1-2024 (Figure 7). At the same time, labor costs grew, which limited the scale of disinflationary processes, especially in the service sector. These factors, combined with oil prices that increased again in April due to the tense military-political situation in the Middle East, prevent from stating the stability of the globally slowing inflation.

Figure 6. Global commodity prices and price pressures in supply chains

a) commodity prices



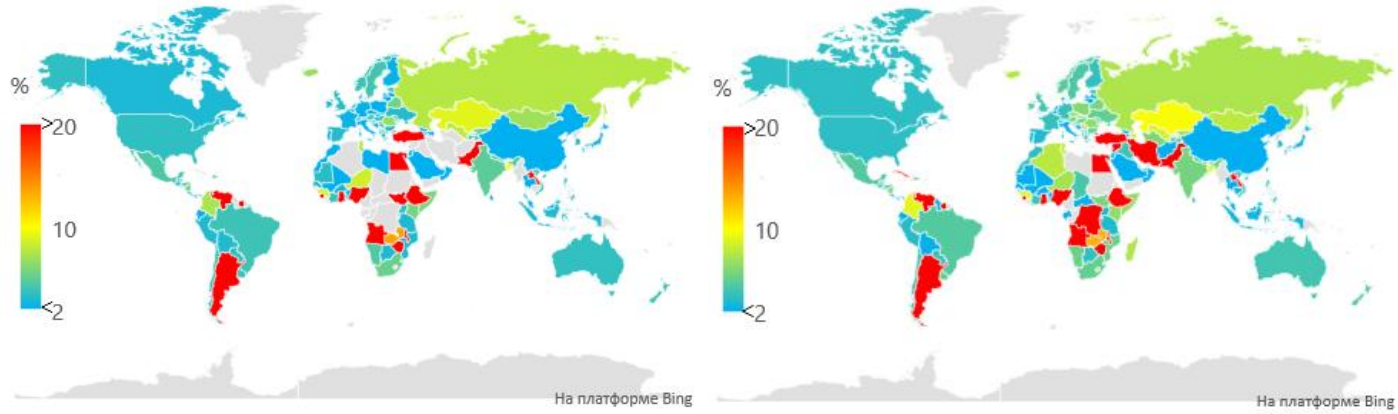
b) supply chain pressure indices



Source: World Bank, Federal Reserve Bank of New York, Drewry World Container Index, Drewry Supply Chain Advisors.
Note: The World Container Index is for the last week of the month.

Figure 7. Global inflation

a) March 2024 (YoY) b) December 2023 (YoY)



Source: Trading Economics, national statistical agencies.
Note: YoY (year-on-year) is the growth rate in the last month of the quarter vs the last month of the corresponding quarter of the previous year.

Inflationary pressure from the Russian market decreased in Q1-2024

Inflation in Russia is estimated at ≈5.9% QoQ in Q1-2024, which is noticeably lower than the inflation rate in the second half of 2023 (Figure 8.b). Translation of heavy weakening of the Russian ruble (versus major currencies) into prices completed, which contributed to decreasing inflationary pressure. At the same time, it persisted due to a colossal shortage of workers and overheated domestic demand. These factors will continue to support elevated inflation in Russia this year, although their impact may decrease due to tightening monetary conditions.

Blanket price control is the main inflation limiter in Belarus

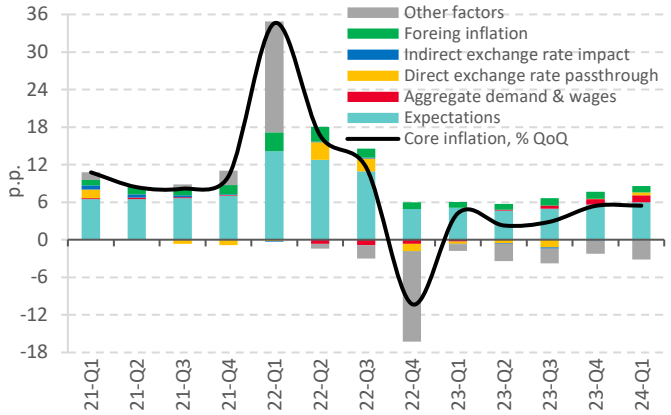
The practice of strict state regulation of domestic prices continued in Q1-2024. Within the QPM, this manifested in a higher negative contribution of the factors not explained by the model (which takes the impact of state regulation of prices into account) to the quarterly dynamics of core inflation in Q1-2024 (Figure 8.a). Leaving out the impact of strict price controls, annual inflation could have been not 5.6% YoY, but about 11% YoY in March 2024 (Figure 2.d). Thus, the inflationary overhang (this is the potential for accelerated price increase in the future) continued to accumulate at the beginning of this year. Its size is estimated at (at least) 6% at the end of Q1-2024.

Inflationary expectations of Belarusian households decreased in Q1-2024

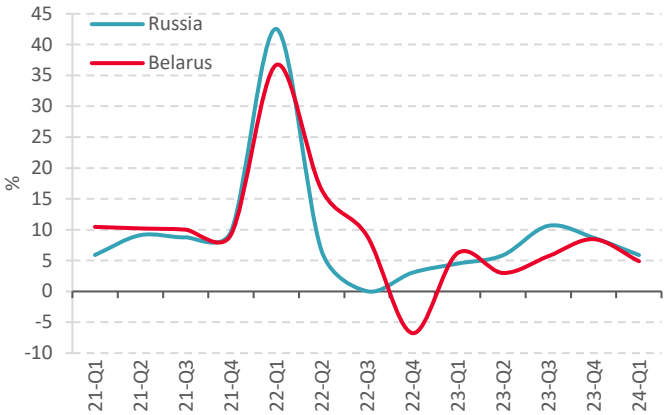
The annual price increase expected by households was 11% in March 2024, thus lowering from 11.5% in December 2023 (Figure 9.a). This is one of the lowest values of the indicator for the entire calculation period since late 2017. Strict price controls and the statements by Belarusian officials about their intention to maintain price controls this year are highly likely to be the key factors restraining inflationary expectations. Core inflation decomposition in the QPM shows that the contribution of rational inflationary expectations to the dynamics of core inflation in Q1-2024 remained lower than in 2021–2022 (Figure 8.a).

Figure 8. Decomposition of core inflation in Belarus and inflation in Russia

a) core inflation decomposition, QPM-based (QoQ, logarithmic data)



b) inflation (QoQ) in Belarus and Russia



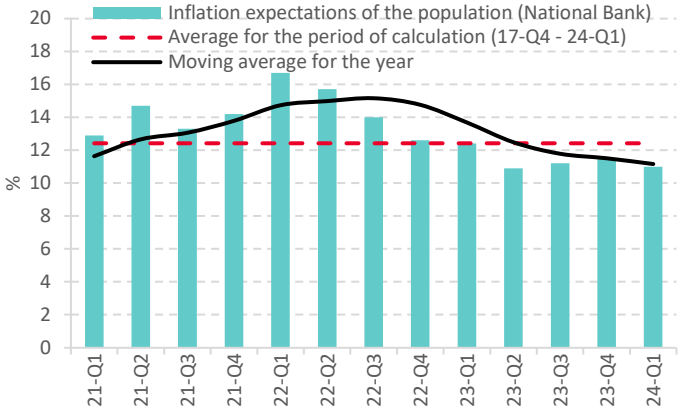
Source: The calculations based on QPM, the data from Belstat and Rosstat.
Note: The contributions of the factors are calculated considering momentum; QoQ (quarter-on-quarter) is the annualized growth rate in the last month of the quarter vs the last month of the previous quarter, seasonally adjusted.

Foreign exchange rate had a restrained inflationary impact in early 2024

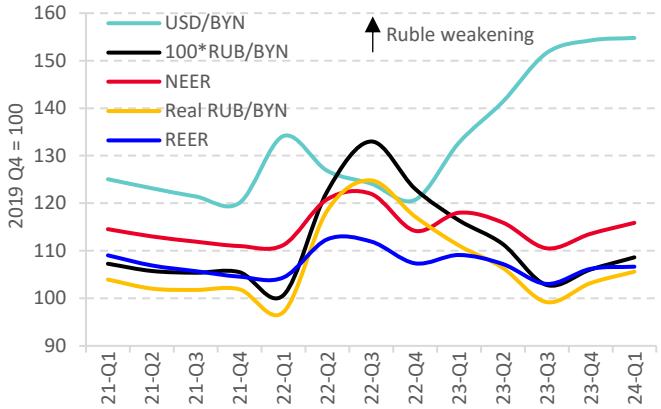
The Belarusian ruble depreciated by 2% on average in nominal terms (measured through the nominal effective exchange rate) in Q1-2024 versus Q4-2023 (Figure 9.b), and it depreciated by 1.6% against the foreign currency basket. As a result, the direct effect of foreign exchange rate pass-through on inflation, which is associated with the impact of the foreign exchange rate on the cost of imports, is assessed as moderately positive (Figure 8.a). The indirect pass-through effect associated with the equalization of prices for traded goods in Belarus and in the trading partner countries of Belarus was slightly positive in January–March 2024 (Figure 10.b): food products in Russia became slightly more expensive on average compared to Belarus, but the price ratio remained around the 2019–2021 values (Figure 5.d).

Figure 9. Household inflation expectations and dynamics of the Belarusian ruble exchange rates

a) annual inflation expected by households



b) Belarusian ruble exchange rates



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

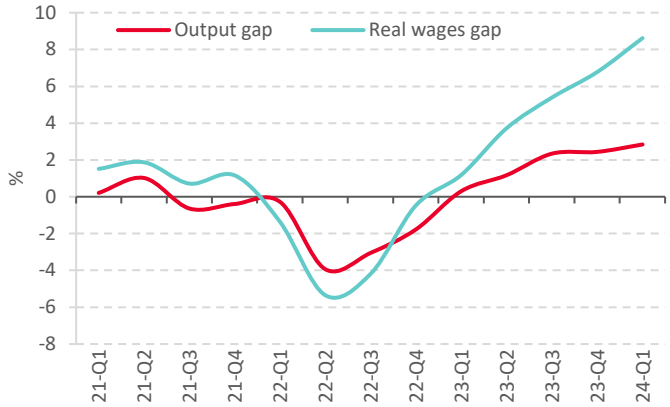
Excess demand in the Belarusian economy is a pro-inflationary factor still

A positive output gap is estimated (through QPM) to be around 2.8% in Q1-2024 (Figure 10.a). This means the economy remained moderately overheated. Expansionary domestic economic policy and excess demand in Russia kept the GDP volume above its balanced level.

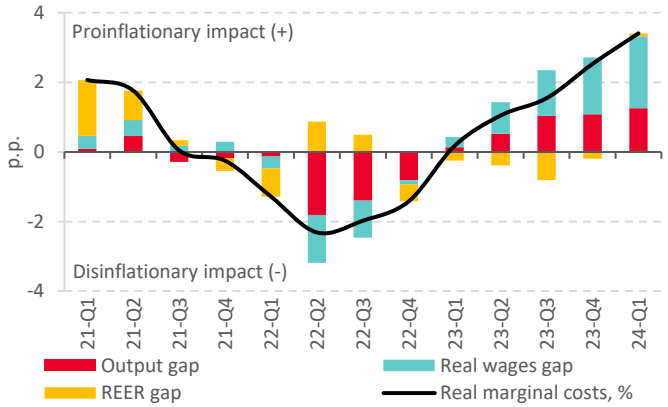
Manufacturers of goods and providers of services are unable to keep up with the increased demand in an environment of personnel shortages and record-breaking capacity utilization.[iii] This puts pressure on costs towards their increase: the cost of goods sold by enterprises increased by 17.1% YoY in January-February 2024. Since strict price controls limit and slow down the pass-through of costs to consumer prices, retail return on sales fell from an average of 1.1% in January-February 2019–2022 to 0.4% in January–February 2023, and to 0.6% in January–February 2024.

Figure 10. Dynamics of indicators of internal inflationary pressure

a) output gap and real wage gap (QPM-based)



b) real marginal cost proxy (QPM-based)



Source: The calculations are based on QPM.

Note: The gaps are re-evaluated once data are available. The real effective exchange rate gap (REER gap) is adjusted for the deviation of relative prices (the ratio of the core CPI to the composite CPI) from the trend.

Rapid rise in labor costs poses a large-scale inflationary threat

Real wages continued to grow at a high rate in Q1-2024. This manifested in the expansion of its positive deviation from the equilibrium (inflation-neutral) level (Figure 10.a), which increased pro-inflationary pressure (Figure 10.b). Wage growth occurs in a tense situation in the labor market, where the challenge of a shortage of workers persists. Thus, the ratio of the number of unemployed (according to Belstat) to the number of vacancies (according to the Ministry of Labor and Social Protection) updated the lowest value for the entire calculation period: slightly more than 1.1 unemployed per vacancy (seasonally adjusted) in Q1-2024. The shortage of workers is one of the key factors limiting output on the supply side; this increases inflationary risks in an environment of overheated demand.

3 Monetary conditions

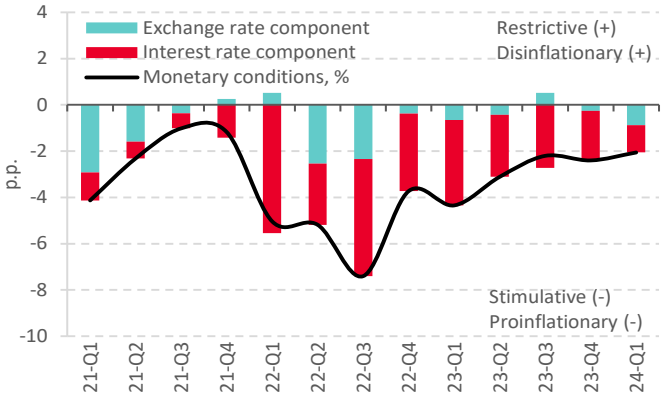
The scale of monetary stimulus decreased in Q1-2024, but remained significant

In Q1-2024, the National Bank increased reserve requirements for banks' liabilities in foreign currencies and re-granted banks' access to standing facilities. 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.

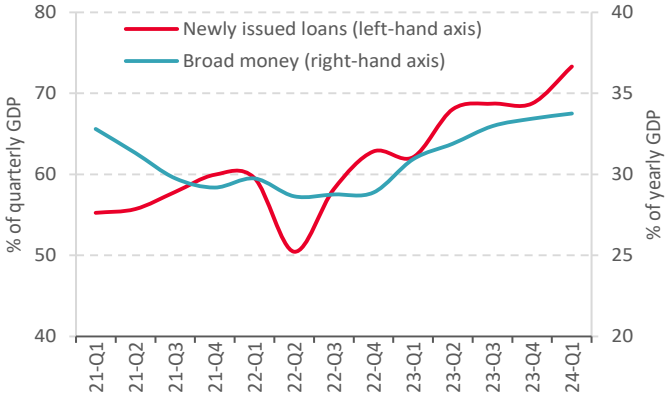
Growth of the interbank lending rate translated into an increase in average interest rates on market loans and time deposits in Belarusian rubles: they grew by 1 p.p. and 1.4 p.p. respectively. At the same time, since the liquidity surplus remained in the banking system, and the National Bank did not conduct auction operations to withdraw this liquidity surplus and did not increase the refinancing rate, interest rates on the credit and deposit market remained below their neutral levels. This means that the scale of stimulus for the economy from the interest rate policy decreased at the beginning of the year, but remained significant (Figure 11.a). Consequently, the measures taken by the National Bank have not been enough to cool down credit activity and overheated demand in the economy in a stable manner (Figure 11.b).

Figure 11. Monetary conditions

a) components of monetary conditions (QPM-based)



b) issued loans and broad money supply (seasonally adjusted)



Source: The calculations based on QPM, data from the National Bank of Belarus, Belstat.
Note: The dynamics of monetary conditions may change once new data are available.

The foreign exchange rate had a restrained stimulating effect on monetary conditions in Q1-2024

The weakening of the Belarusian ruble in late 2023 and in early 2024 manifested in shaping its undervaluation in terms of the Real Effective Exchange Rate (Figure 11.a). Thus, the foreign exchange rate factor supported the price competitiveness of Belarusian producers, but this support was estimated as small. The scale of undervaluation of the national currency had a moderate positive impact on inflation (Figure 10.b).

4 Short-term forecast

The Belarusian economy will continue to operate in a state of excess demand and a deficit labor market in 2024

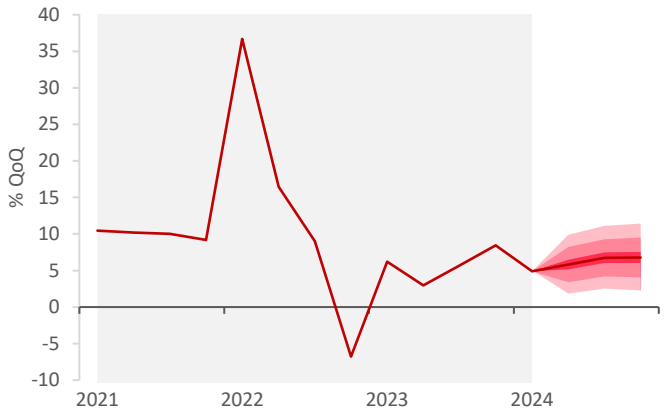
The dynamics of economic activity will weaken in 2024 due to the reached ceiling of the extensive utilization of production capacity and the expected narrowing of market monetary incentives. However, continued practice of directed lending, the likely application of budgetary and quasi-fiscal instruments, as well as an attempt to satisfy the overheated demand in Russia to the maximum extent will slow down the rate of returning the economy to an equilibrium state. As a result, the positive output gap will remain significant: about 2.5–3% on average in 2024. In the environment of excess demand, the Belarusian ruble has the prerequisites for a moderate weakening in 2024, which will increase the cost of imports in Belarusian rubles. The shortage of workers will continue to push up wages, although the severity of the issue may decrease due to fading emigration and weakening dynamics of economic activity.

Pro-inflationary pressure will remain elevated in 2024, but blanket price control will restrain transformation of the pressure into actual inflation

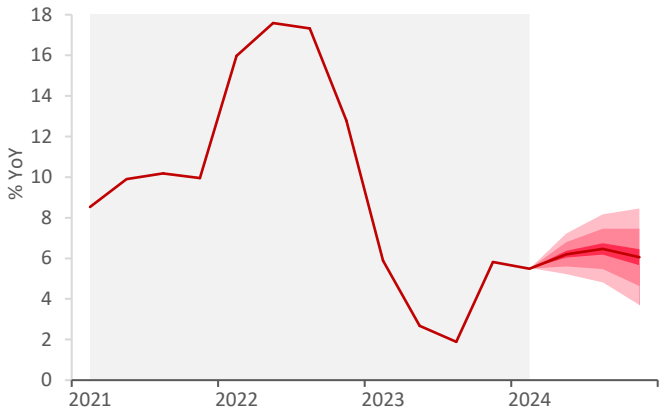
Excessive demand in the economy, shortage of staff, the projected weakening of the Belarusian ruble, and constant adaptation to sanctions will stimulate the growth of costs for producers of goods and providers of services. Price pressure from the Russian market will remain, but it will weaken in the second half of 2024 as inflation slows down in Russia. In combination with the inflationary overhang accumulated by the beginning of 2024, the transformation of the identified factors into actual price increases could lead to inflation accelerating closer to 10% YoY this year. At the same time, the Belarusian authorities plan to maintain strict price controls in 2024. Together with a conservative approach to increasing regulated prices and tariffs, this will limit the transfer of pro-inflationary factors into actual price increases, as a result of which annual inflation is projected to be 5-7% YoY (Figure 12.b). The flip side of the excessive use of administrative tools will be an increased threat of growing commodity deficits and the expanded inflationary overhang.

Figure 12. Inflation forecast for Belarus

a) quarterly inflation (QoQ)



b) annual inflation (YoY)



Source: The calculations are based on QPM.

Note: YoY (year-on-year) is the growth rate in the last month of the quarter versus the last month of the corresponding quarter of the previous year; QoQ (quarter-on-quarter) is the annualized growth rate in the last month of the quarter versus the last month of the previous quarter, seasonally adjusted. The Figure shows seasonally adjusted indicators. The ranges in the figure correspond to the 15%, 50% and 75% confidence intervals.

5 Forecasting risks

In the middle of the year, the Belarusian authorities will find themselves at a fork in the road: either to expand demand stimulation to get closer to the GDP growth target, while forgetting about price stability, or to allow the economy to cool down, while abandoning the GDP growth target

Domestic economic policy in Belarus remains ad hoc and lags in responding to shocks. This can generate extremely high economic cycle volatility and inflation if the economy is exposed to severe shocks.

By mid-2024, the accumulated Belarusian GDP growth rate will decrease significantly, and the Belarusian authorities will have to choose: either to use additional incentives in an attempt to get closer to the target GDP growth of 3.8% (but this will require easing price controls) or to forget about achieving this goal and focus on fighting inflation, most likely by administrative tools.

The first option increases the threat of macroeconomic and financial destabilization, since approaching the output target in an already overheated economy will require a colossal pumping of domestic demand. This will increase the positive output gap into the range of 5–6% by the end of 2024: a similar imbalance occurred in Belarus only before the crisis periods of 2009, 2011, and 2014–2015.

The second option could contribute to the gradual resorption of price pressure from domestic demand and keep inflation close to 5% in 2024. However, long-term containment of price increases by administrative methods will be associated with maintaining an inflationary overhang, the threat of growing commodity deficits, and the gradual fading of investment activity. A positive scenario would be not to expand economic incentives combined with weakening price controls, which, other things being equal, would gradually reduce the scale of accumulated macroeconomic imbalances.

Price regulation may be relaxed if the financial standing of enterprises critically deteriorates

The profitability indicators of enterprises noticeably deteriorated in 2023 and in early 2024, which was a consequence of applying a strict system of price controls in the domestic market and deterioration in foreign trade conditions. This year, the financial standing of firms may suffer even more due to tightening price regulations and in the event of logistics chain disruptions and/or increased external inflationary pressure. If this scenario materializes, the threat of the NPL crisis (non-performing loans) may become tangible and affect the banking system. As a result, the economy will plunge into recession, coupled with a higher inflation and a significant weakening of the Belarusian ruble, and the duration and depth of the recession will depend on the responses of the authorities. The mildest consequences are expected in the event of a sharp weakening of the administrative impact on business and the repeal of Resolution 713 on price regulation, which will enable to activate the internal adaptation mechanisms of the economy to shocks.

Pro-inflationary risks from the external sector remain relevant

The tense global military-political and social situation shapes the main risks and threats to economic development. Any strong escalation of the military-political conflict, especially in the Middle East, will be associated with logistics chain disruptions and a possible reduction in energy commodity production. This in turn will lead to a strong increase in inflationary pressure in the world, coupled with weakening economic activity. Heavy external inflation shocks will significantly limit the ability of the Belarusian authorities to curb price growth by administrative levers and will require softer price controls due to the accumulated inflationary overhang and the threat of financial destabilization.

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. 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.

Wage gap

This is deviation of real wages from their equilibrium level. A positive gap indicates that wages are above the level corresponding to the potential GDP, and it is an indicator of inflationary pressure. The opposite is true for a negative 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.

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.

Real marginal costs

This is approximation of the incremental costs of producing an additional unit of output. Real marginal costs are a combination of output, wages, and real effective exchange rate gaps. Output and wage gaps approximate the costs of domestic producers, while the real effective exchange rate gap approximates the costs of importers. Positive values indicate a pro-inflationary pressure, and negative values indicate a disinflationary pressure.

Notes

[i] 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). All quarterly inflation values in the Bulletin (unless indicated otherwise) are presented as annualized (annual equivalent).

[ii] The Quarterly Projection Model (QPM) was used to estimate the impact of the price regulation system (updated in October 2022) on inflation. A historical decomposition of inflation was based on the model: the dynamics of the indicator were decomposed into the contributions of shocks. The values of actual and synthetic annual inflation were compared. In the latter case, the indicator was calculated by subtracting — starting from Q4-2022 — the contribution of the core inflation shock (which approximated the impact of tightening price regulation) from the actual inflation value. It is noteworthy that the core inflation shock includes not only the impact of price controls, but also other factors not considered in the model directly. However, the magnitude of the core inflation shock is usually small (except the periods of strong shocks), while a large negative shock was identified in Q4-2022, which continued throughout 2023 and Q1-2024.

[iii] According to the Ministry of Economy of Belarus, production capacity utilization in the industrial production sector in September 2023 reached its highest level since 2013 — 70% — and remained close to this level (68–69% in February-March 2024). The ratio of the number of unemployed (according to Belstat) to the number of vacancies (according to the Ministry of Labor and Social Protection) was slightly more than 1.1 unemployed per vacancy (seasonality adjusted) in Q1-2024. Until 2022, the indicator sustainably exceeded 2.0 unemployed persons per vacancy.