Belarus Economy Monitor:
trends, attitudes, and expectations

Express Analysis
Economic activity and inflation

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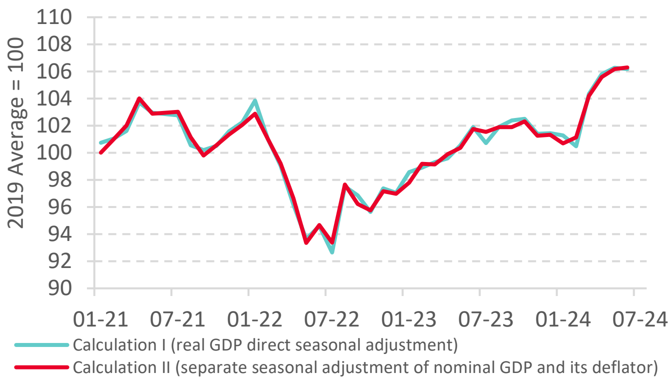
Belarus' GDP growth greatly exceeded its balanced rate in Q2-2024, but its dynamics weakened in May–June

GDP grew by 5% YoY in January–June 2024, and it grew by ≈3.8% YoY in June only (Figure 1.b). Seasonally adjusted output remained near the level observed in May following a noticeable growth in the spring (Figure 1.a). Overall, GDP growth accelerated to 5.5% YoY in Q2-2024 following a 4.3% growth YoY in Q1-2024. GDP volume (seasonally adjusted) increased by ≈2.3–2.4% versus Q1-2024 and exceeded the 2021 average by ≈3.7% (Figure 2). The output dynamics greatly exceeded its balanced rate in Q2-2024. Overheating of the economy has increased to more than 3.5% of potential GDP (according to preliminary estimates).

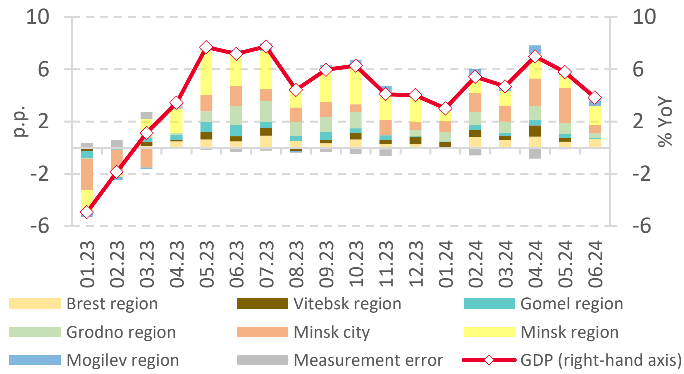
High consumer spending, elevated investment activity and increased demand in Russia, including in the military-industrial complex, supported GDP growth in Q2-2024. Further rapid expansion of the overheated economy is increasingly constrained by production capacity limitations and increased competition in the Russian market. Therefore, stagnation is the most likely scenario for the second half of the year. If this scenario materializes, GDP growth will be generally around 4% in 2024. At that, intensified investments in expanding production capacity and increasing labor productivity may be needed to sustain the achieved record-breaking output volume.

Figure 1. Dynamics and structure of GDP growth in Belarus

a) GDP volume in constant prices based on monthly data (seasonally adjusted)



b) regional structure of annual GDP growth (% YoY)



Note: The estimates update once the data are verified. The energy sector includes the water supply and sanitation subsector. Monthly GDP data are estimates, and they should be treated with caution.

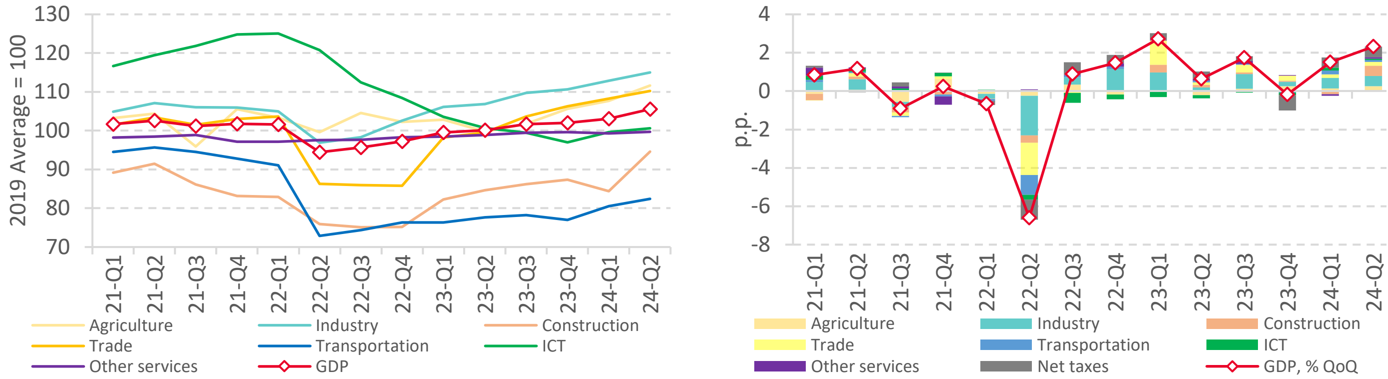
The agriculture and construction sectors supported GDP in June and ensured the acceleration of its growth in Q2-2024: the contribution of the agriculture sector to the quarterly GDP growth was estimated at ≈0.3 p.p., and the contribution of the construction sector was estimated at ≈0.5 p.p. (Figure 2.b)

Agricultural output grew by 17.6% YoY in June. Overall, value added of the sector (seasonally adjusted) grew by ≈3.7% in Q2-2024 versus Q1-2024 (Figure 2.a). Earlier sowing and harvesting campaigns influenced by weather conditions have become a key factor of agricultural output growth. The sector was also supported by strong domestic and external consumer demand. Agricultural output dynamics will be volatile in the coming months due to uneven harvests in 2023 and 2024. At the same time, the impact of the current year's climate on the final harvest is a significant factor of uncertainty.

The volume of construction works in June added more than 5% to the level of May (Figure 4.b)**, and in general, the value added of the construction sector (seasonally adjusted) grew by ≈12.1% in Q2-2024 versus Q1-2024** (Figure 2.a). The growth in June and in Q2-2024 was partly compensatory following the decline in the previous quarter, but it partly reflected higher investment activity. Investments in fixed capital in Q2-2024 could have added more than 5% to the level of Q1-2024 (seasonally adjusted). Since their monthly dynamics were "ragged" (Figure 4.b), and their volume remained below the 2021 average, it is still too early to measure investment growth sustainability. However, adjusting producers to increased demand requires intensifying investment activity to expand production capacity and increase labor productivity. This is especially relevant in the context of increased competition in the Russian market.

Figure 2. Dynamics of GDP and value added in Belarusian sectors

a) GDP volume in constant prices based on quarterly data (seasonally adjusted) b) sectoral structure of quarterly GDP growth (seasonally adjusted, % QoQ)



Note: The indicator dynamics updates once new data are published.

The industrial sector maintained its high growth rates in Q2-2024 and contributed ≈0.5 p.p. to quarterly GDP growth (Figure 2.b)

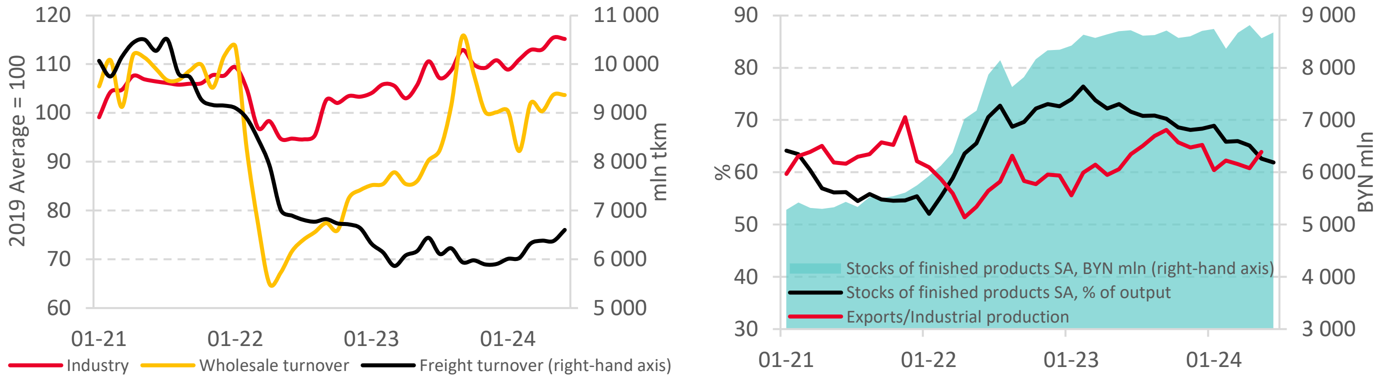
In Q2-2024, seasonally adjusted value added of the industrial sector grew by ≈1.9% versus Q1-2024, including more than 2% in manufacturing industries. Output growth was accompanied by a noticeable decrease in inventories relative to production volume, which indicated continued high demand in the domestic and foreign markets. In the latter case, the strong growth in economic activity in Russia was influential, which could mainly support the food, engineering (mostly related to the military-industrial complex) and metallurgical complexes, and this was accompanied by increasing exports (Figure 5).

Separately, industrial output (in real terms, seasonally adjusted) fell slightly in June following its strong growth in the spring (Figure 3.a). Regional dynamics indicate a likely downward adjustment in oil refining, mechanical engineering and, possibly, metallurgy following their growth in May. **Further growth in industrial output is questionable in an environment of full capacity utilization and high competition in the Russian market.** It seems most likely that it will slow down and move to stagnation dynamics. It is important to understand that even such a scenario involves investing in improving productivity, because otherwise even maintaining output at this level will be very challenging.

Figure 3. Dynamics of industrial output, wholesale trade and transport freight turnover

a) real industrial output (SA) and wholesale trade (SA), freight turnover (SA)

b) industrial stockpiles, and the ratio of goods exports to output



Note: SA is a seasonally adjusted indicator. The real volume of wholesale trade has been calculated by deflating the nominal volume by the wholesale trade price index. The real industrial output volume has been calculated based on the Belstat's Industrial Output Index in 2015 prices. The dynamics updates once new data are published.

Value added in the transport sector increased by ≈2.4% in Q2-2024 versus Q1-2024 (seasonally adjusted), which added ≈0.1 p.p. to quarterly GDP growth (Figure 2.b)

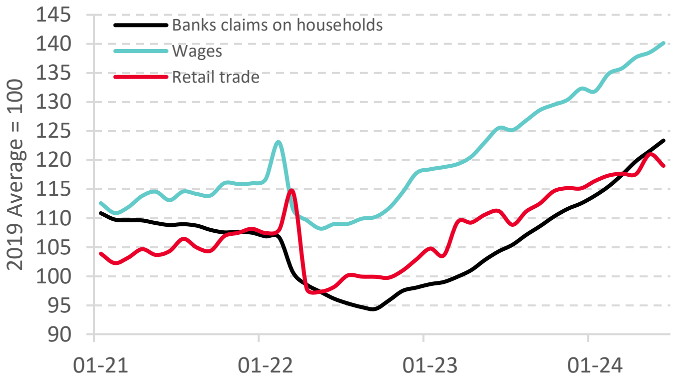
There was an increase in cargo turnover (Figure 3.a), while passenger traffic stagnated in June. In general, both the volume of freight and passenger transport services increased in Q2-2024. This was likely facilitated by expanding domestic demand and increasing exports of goods (Figure 5.a), which led to an increase in demand for the services to transport exports. Despite its growth in Q2-2024, value added in the transport sector remained more than 12% below its 2021 average, and cargo turnover in June was more than 33% below its 2021 levels (Figure 3.a).

The ICT sector showed weak growth in seasonally adjusted value added in Q2-2024: ca. 1% growth versus Q1-2024

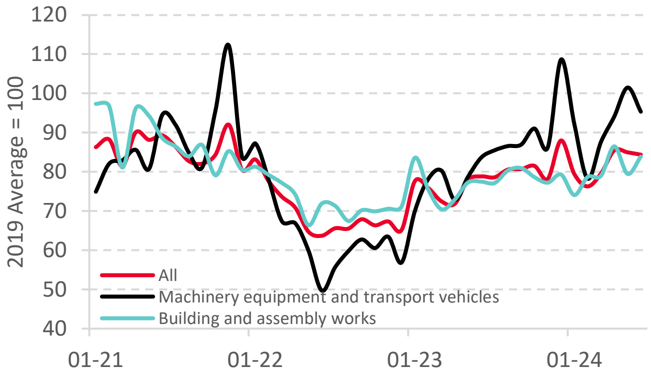
The information and communications sector has demonstrated a muted out recovery for two quarters in a row after a two-year decline: its value added in Q2-2024 remained at the level of mid-2019, falling almost 17% short of the 2021 average (Figure 2.a). Even this limited recovery of the ICT and transport sectors contributed to higher exports of services relative to GDP and an expansion of the surplus in foreign trade in services to 4.2–4.3% of GDP (seasonally adjusted) in April–May 2024 (Figure 5.b). This scale of surplus falls far short of the 2017–2021 figures (on average 6% of GDP), which carries the risk of increasing the trade deficit in goods and services if the process of adjusting producers to high demand is delayed.

Figure 4. Retail trade and investment dynamics

a) retail trade, wages and lending (seasonally adjusted, in real terms)



b) investment (seasonally adjusted, in real terms)



Note: Real retail trade volume is calculated by deflating nominal volume by the Consumer Price Index for goods. Real wage has been calculated by deflating the nominal wage by the Composite Consumer Price Index. Real investment indicators have been calculated by deflating nominal investment by construction price indices. The indicator dynamics updates once new data are published.

Consumer demand slightly adjusted downward in June following its surge in May (Figure 4.a), but overall it increased noticeably in Q2-2024

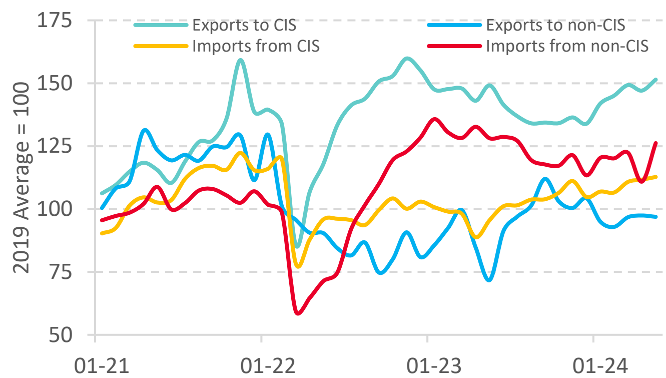
According to preliminary estimates, household spending on goods and services could increase by almost 2% in Q2-2024 versus Q1-2024 (seasonally adjusted) and exceed the average level of 2021 by more than 18%. Expansion of lending against the backdrop of non-restrictive interest rates and preferential lending programs (Figure 4.a), higher wages in an environment of labor shortages, high levels of consumer confidence and, probably, increased state budget expenditures continued expanding the households' demand for goods and services. Strengthening consumer demand and expanding exports of goods reflected in a ≈1.9% growth (seasonally adjusted) of value added in the trade sector in Q2-2024 versus Q1-2024 (Figure 2.a).

The GDP volume was already more than 3.5% (according to preliminary estimates) above its balanced level in Q2-2024 in an environment of overheated consumer activity

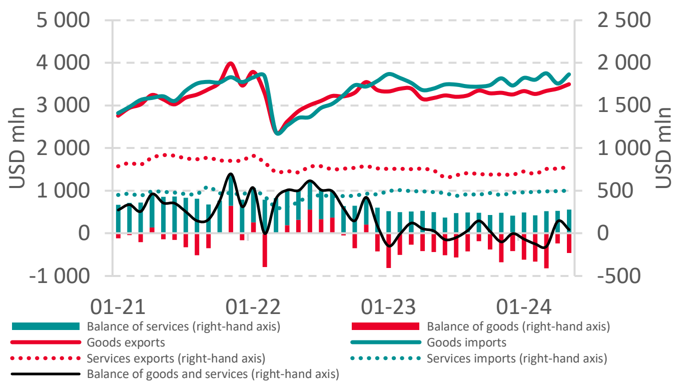
The overheating has reached a serious scale, and adjusting supply to increased demand will require time and intensified investment. In this regard, domestic economic policy should become less stimulating and even moderately tough to prevent growing imbalances in the economy. This will cool demand and quickly return the economy to an equilibrium state.

Figure 5. Dynamics of foreign trade indicators

a) value volumes of goods exports and imports (seasonally adjusted)



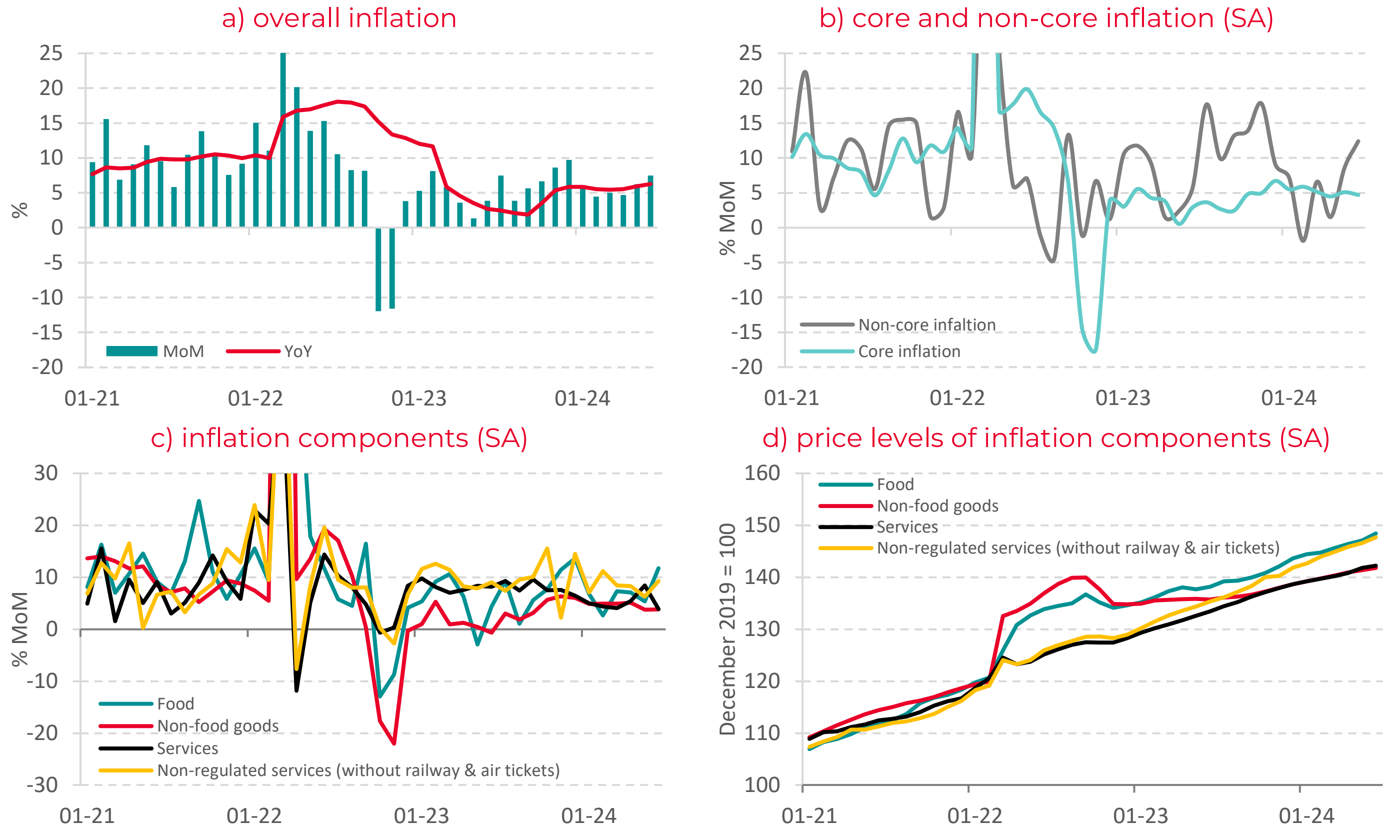
b) value volumes of foreign trade (seasonally adjusted)



Note: The indicator dynamics updates once new data are published.

Inflation increased in June due to volatile prices for fruits and vegetables: annual growth rate was 5.84% YoY in June 2024 following 5.72% YoY in May 2024, and annualized monthly price growth (seasonally adjusted) was estimated at about 7.5% MoM (Figure 6.a)

Figure 6. Inflation dynamics in Belarus



Note: YoY (year-on-year) is a monthly growth rate versus the corresponding month of the previous year; MoM (month-on-month) is an annualized monthly growth rate (seasonally adjusted) versus the previous month. SA is a seasonally adjusted indicator.

Accelerating inflation is fully explained by the dynamics of its non-core component (Figure 6.b). In terms of non-core inflation, there was a significant increase in prices for fruits and vegetables by ≈40–50% MoM in annualized terms (seasonally adjusted). The rate of increase in potato prices in June turned out to be tens of percent higher than the seasonal rate; this is explained by challenged supplies of the imported root vegetable. Inflation accelerated in the food segment in June 2024 largely due to the rise in prices for fruits and vegetables (Figure 6.c).

Core inflation remained rather low in June considering the prevailing macroeconomic conditions: it was below 5% MoM (seasonally adjusted) (Figure 6.b). The annualized seasonally adjusted price increase in non-food products remained slightly below 4% MoM in May-June (Figure 6.c). This pace is extremely restrained and conditioned by the practice of blanket price controls, which does not allow pro-inflationary factors to freely transform into rising prices for goods. The price pressure of increased costs remains noticeable in unregulated services (but for highly volatile international rail and air transport services): annualized seasonally adjusted price growth is estimated at more than 9% MoM in June 2024 and about 8% MoM on average in Q2-2024 (Figure 6.c).

Inflation in market personal services exceeded 11% MoM in June, and it was close to the 10% average MoM in Q2-2024, highlighting high inflation pressures in an environment of understaffing, heavy wage growth and overheated consumer demand. Prices for unregulated services are increasingly moving away from prices for non-food products, which signals a widening inflationary overhang (Figure 6.d). However, **annual inflation will remain around 6% YoY in July, and monthly consumer price growth will remain subdued in a price regulation environment**

The National Bank responded to increased inflationary pressure and pro-inflationary risks belatedly, extremely limitedly and not entirely consistently

The overnight loan rate increased by 0.5 p.p. to 11% on July 17; the reserve ratio for funds borrowed by banks in foreign currency will increase by 2 p.p. to 20% on August 1. The National Bank refrained from explaining the need for precisely such actions, which emphasized poor quality of its communication policy. The decisions were made on Friday, July 12, which was atypical for the National Bank and indicated the emergency nature of its decisions. The National Bank must have responded in this way not to increased excess demand in the economy, but to the inflation data released in Russia on July 10. Thus, the annualized seasonally adjusted monthly price increase in Russia exceeded 9% MoM in June, and it is highly likely to exceed 10% MoM in July. In such conditions, the chances that the Bank of Russia will raise its key rate to 18% on July 26 have increased significantly. High inflation in a key economic partner country and a significant interest rate gap in the markets of the two countries fuel inflationary risks and exchange rate volatility risks in Belarus. This, apparently, has triggered decisions on tightening monetary conditions.

Increasing the reserve ratio will allow to withdraw about Br 0.4–0.5 billion of excess liquidity from the banking system

In recent months, the liquidity surplus averaged Br 1–2 billion. At the same time, banks placed on average slightly less than 60% of this surplus in overnight deposits in the first half of the year. This may indicate that banks need some of the free resources to ensure uninterrupted operations, and they have no incentives to invest these resources in loans. In this case, **an additional withdrawal of Br 0.4–0.5 billion starting from mid-August will practically neutralize the excess liquidity of banks, provided there are no positive foreign trade shocks.** This should reflect in an increase in the average interbank market rate (IBL) starting from August and in higher interest rates on Belarusian ruble market loans and deposits in the autumn.

An increase in the interest rate on overnight loans without an increase in the interest rate on overnight deposits looks strange, and this indicates that the National Bank is under a strong administrative pressure specifically as far as the latter benchmark for the cost of money is concerned

The range of interest rates of the National Bank for standing facilities has expanded even more – to 4–11%. If the National Bank continues not to enter the market with auction operations, then the interbank lending rate will remain extremely volatile. It will be in the range of ≈4–7% in the first three weeks of the month (when there is excess liquidity in the system), and it will rise to ≈7–11% in the last week of the month (when there is a deficit in the system).

As a result, **the average interbank loan rate may move from 4–6% in the first half of 2024 to ≈6–8% starting from August-September 2024. The average interest rate on Belarusian ruble market loans may increase by 0.2–0.4 p.p. in August–September and by 1–1.4 p.p. by the end of the year; the average interest rate on Belarusian ruble time deposits may increase by 0.6–1 p.p. in August-September and by 1.3–1.7 p.p. by the end of the year.** At the same time, the range of probable deviations from the presented estimates is significant due to the extremely wide interest rate corridor built by the National Bank and due to high uncertainty of external conditions. The measures taken by the National Bank will be effective in terms of influencing loan rates only if there is a corresponding increase in the estimated values of standard risk, which set the upper limit for the cost of market lending.

If inflation remains close to 6% YoY and inflation expectations are stable, such an increase in interest rates will mean narrowing of monetary incentives and gradual moving of monetary conditions to a neutral state

This will contribute to a gradual weakening of the pace of lending and demand growth.. However, **to cool down an overheated economy, it is not enough to bring monetary conditions closer to a state that would be neutral for business activity.** It is necessary to transfer monetary policy to a state of moderate rigidity with a corresponding limitation on directed lending and the rate of expanding budget expenditures.