Belarus Economy Monitor:
trends, attitudes and expectations

Monetary Environment Review
Q4-2023

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Monetary conditions will become less stimulative in 2024, but the National Bank cannot explain what degree of their strictness corresponds to ensuring macroeconomic stability

Monetary conditions remained loose in Q4-2023 mainly due to low interest rates in the credit and deposit market (Figure 1). The foreign exchange rate is no longer a restraining factor for inflation, which accelerated noticeably at the end of last year amid an overheated economy and a tense situation in the labor market.

The National Bank took actions aimed at narrowing monetary incentives for private businesses and households at the end of 2023 in response to inflation risks and the high social and political costs of their implementation for the authorities. In 2024, the stimulative effects of market interest rates on economic activity are expected to decline (Figure 1). At the same time, the public sector will retain its preferential access-to-finance conditions, which will limit monetary policy effectiveness.

Figure 1. The nature of the monetary conditions of the Belarusian economy
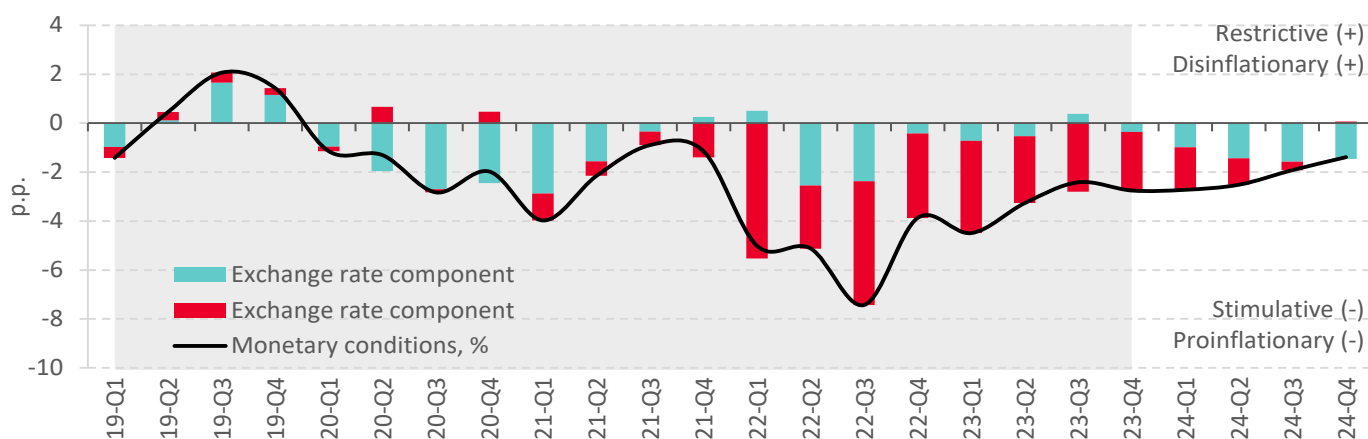
Source: The BEROC's calculations are based on the BEROC's Quarterly Projection Model (QPM) for Belarus.
Note: Monetary conditions are estimated as a combination of deviations of real interest rates on the Belarusian ruble assets and of the real effective Belarusian ruble exchange rate from their equilibrium 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.

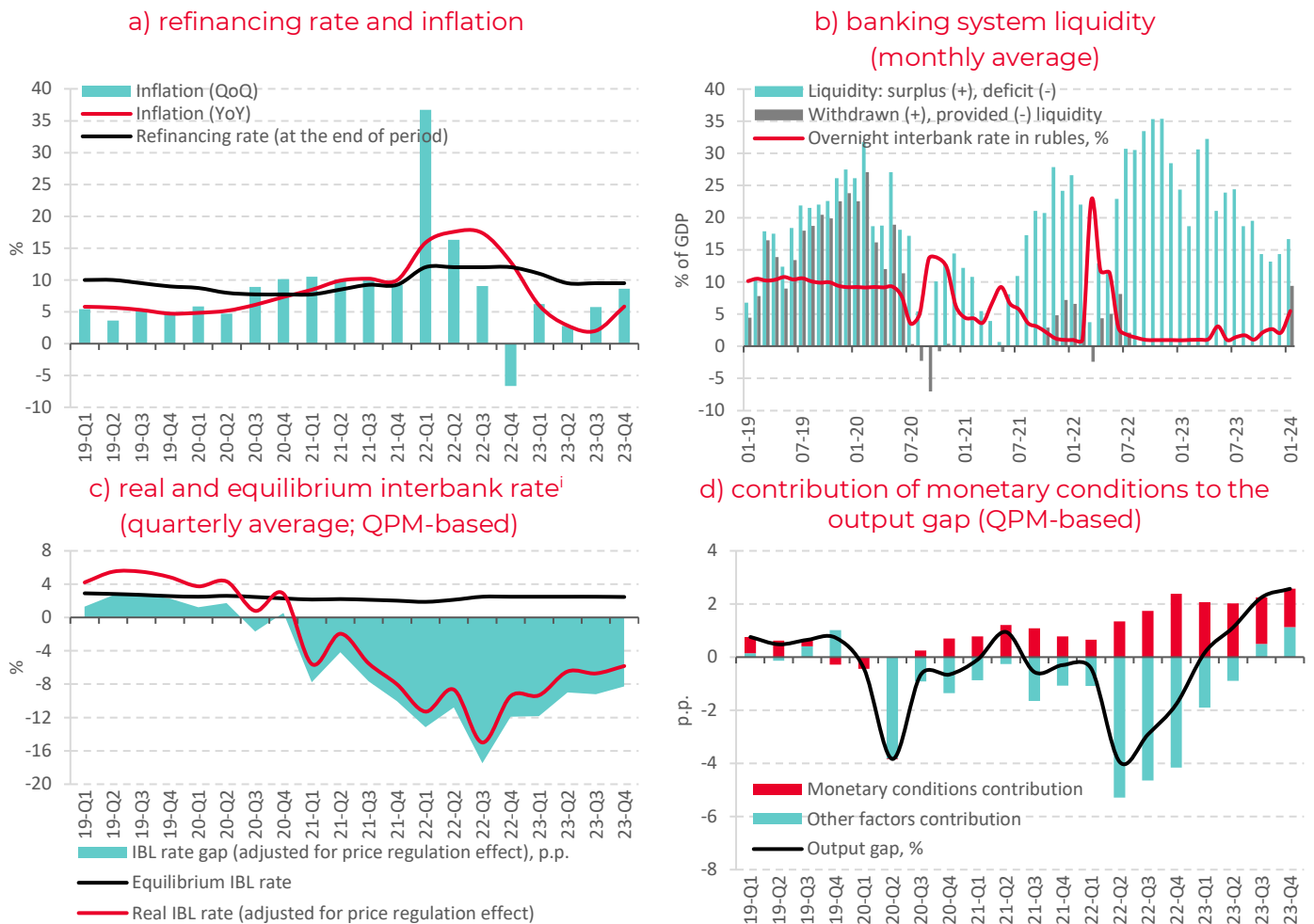# 1 Monetary policy: measures, direction, nature

Monetary policy remained loose in Q4-2023

The National Bank did not change the refinancing rate, which remained at 9.5% (Figure 2.a). In Q4-2023, the banking system continued to operate in a state of excess liquidity (Figure 2.b); its volume decreased in 2023 largely because of more cash in circulation, which increased by 39.4% over the year. Since the National Bank did not apply standard tools for regulating liquidity, excess liquidity manifested in maintaining a low nominal interest rate in the interbank market (Figure 2.b). In real terms, the interbank rate fell significantly short of its equilibrium level: monetary policy remained extremely loose (Figure 2.c).

Expansionary monetary policy supported excess demand

A positive output gap in Q4-2023 estimated through QPM is ≈2.5%. Loose monetary conditions mainly created by interest rates (Figure 1) remained a factor in maintaining excess demand (Figure 2.d) primarily in the consumer segment. Inflation pressure increased in Q4-2023 in an environment of overheated economy and a tense situation in the labor market (Figure 2.a). This likely prompted the government not to interfere with the National Bank's adoption of measures for a limited monetary policy tightening effective since January 2024.

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: BEROC's calculations based on the data by Belstat, National Bank of Belarus, QPM BEROC.
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] January 2024 evaluation.

The National Bank took actions aimed at narrowing monetary incentives for private businesses and households at the end of 2023 in response to inflation risks and the high social and political costs of their implementation for the authorities

The National Bank increased the Estimated Standard Risk Values (ESRV) for December 2023, which de facto set the upper limit for the cost of market bank lending for businesses and households. Subsequently, ESRV was raised two more times, bringing ESRV to 11.61% for market loans to businesses by February 2024 (it was 10.82% in November 2023) and to 16.63% for loans to households (it was 14.61% in November 2023).

The reserve ratio for banks' foreign exchange liabilities has been increased by 2 percentage points since January 2024. This measure is focused on withdrawing Br 0.4–0.5 billion of excess liquidity from banks, since reserves are formed in Belarusian rubles regardless of the currency of banks' liabilities. At the same time, the banking system will continue to operate in a state of liquidity surplus if there are no heavy shocks, since liquidity surplus has been fluctuating around Br 2.5-3 billion at the end of 2023 — beginning of 2024.

On January 3, 2024, the National Bank allowed banks to use standing facilities again. Access to these operations had been suspended since September 2020, and this caused a strong increase in the volatility of the interbank rate (Figure 2.b). The National Bank set the overnight deposit rate at 4% and the overnight loan rate at 10.5%. Rates on deposits and overnight loans set the boundaries of the interest rate corridor for the National Bank's operations, within which the interbank rate will fluctuate, if there are no heavy shocks. **An extremely wide and asymmetrical interest rate corridor relative to the refinancing rate indicates that the National Bank and the government intend to maintain loose monetary conditions at the beginning of 2024, only narrowing the scale of the stimulus to a limited extent.**

The National Bank vaguely formulated the mechanism for returning to auction operations for regulating bank liquidity, and there were not auction operations in January. These operations are designed to ensure the dynamics of the interbank rate is close to the refinancing rate. The irregularity of auctions means continued increased volatility of the interbank rate.

Monetary and macroprudential policy decisions made by the National Bank in late 2023 and early 2024 will lead to only a slight decrease in the stimulating effects of interest rates in Q1-2024 (Figure 1)

Since auctions are still not being held at the beginning of this year, excess liquidity remains in the banking system; however, the interbank rate reached the lower limit of the interest rate corridor for the National Bank's operations in January 2024 and amounted to 5.5% on average for the month (Figure 2.b). **The interbank rate close to 5% with inflation above 5% (while it is expected to increase) is not a limiting factor for economic activity and price growth,** and the increase in the rate from its December 2023 level of 2.2% means only a slight decrease in monetary policy looseness. At the same time, **the preservation of the unchanged refinancing rate** (to which directed lending is tied) **and the activation of the National Bank's issuance operations** through the purchase of government bonds on the secondary market in the amount of almost Br0.8 billion **in Q4-2023 indicate the inconsistency of the macroeconomic policy design and the fact that authorities maintain preferential access of the public sector to monetary resources.**

Communications of the National Bank give reason to believe that it does not have a clear understanding of the state of the economy, the nature of monetary policy and the scale of accumulated imbalances, and does not have a clear understanding of the economic prospects in 2024

In addition to the contradictory design of macroeconomic policy, the National Bank's communications contain contradictory messages. So, despite the statements made by some National Bank experts about a non-existing inflation overhang,[iii] **the decomposition of core inflation presented by Sergei V. Kalechits** at an extended meeting of the Board of the National Bank on January 25, 2024 **contains a large-scale contribution of the factors — not considered in the National Bank's model — to the inflation dynamics in Q4-2022 through to Q4-2023.**[iv] **This indicates either that the National Bank's toolkit records a significant inflation overhang or that the National Bank's core model cannot adequately explain the dynamics of inflation and assess the state of the Belarusian economy.**

The report by S. V. Kalechits stated excess growth in money supply in 2023 and demonstrated that the National Bank estimated the deviations of GDP and real wages from their equilibrium levels as significantly positive at the end of 2023. At the same time, the National Bank's Inflation Report states that "monetary policy has maintained its focus on creating conditions conducive to limiting inflation processes," and budget policy was neutral to economic activity.[v] However, the National Bank does not explain why the economy overheated and the growth of the money supply doubled the target in 2023 (it was 28.1% (YoY) while the target had been 12–16%).
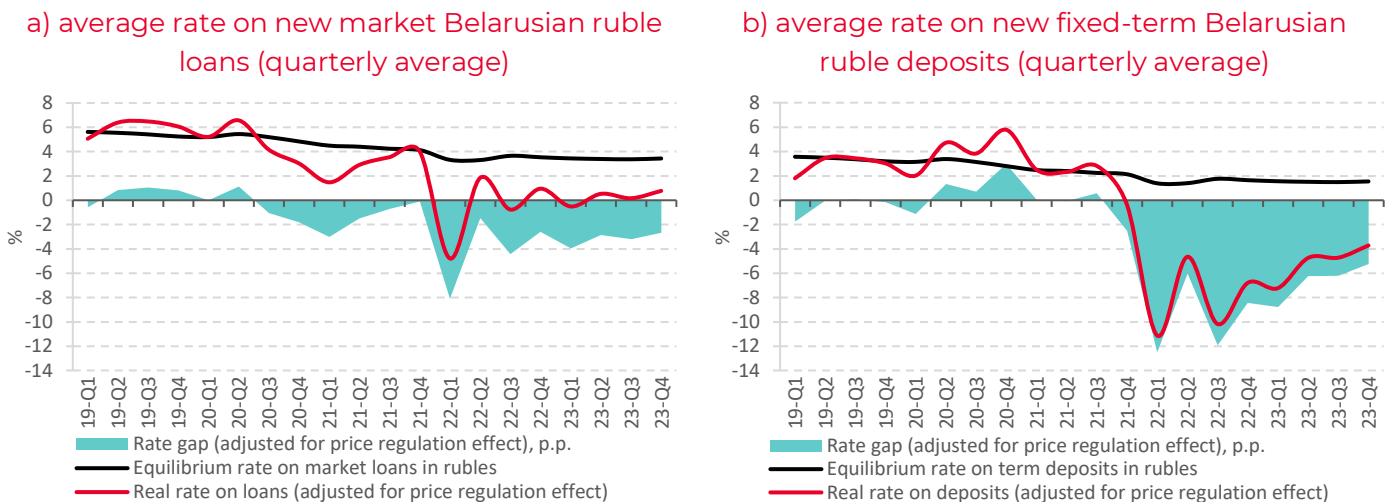
The regulator cannot clearly explain what degree of monetary policy tightness corresponds to the objective of ensuring macroeconomic stability. The output gap dynamics presented in the National Bank's Inflation Report allows us to confidently determine that the regulator estimates the growth of Belarus' potential GDP at about 1% per year. Since the space for recovery growth has been exhausted (according to the National Bank, the positive output gap was about 2% in Q4-2023), this means that economic growth higher than by 1% in 2024 (the government plans to ensure 3.8%) will lead to economy overheating and macroeconomic stability risks. A "healthy" response to this would be to make monetary policy contractionary. The National Bank continues to communicate the need to grow lending and money supply under the 2024 targets estimated based on the assumption of the balanced economic growth of almost 4%, which is refuted by the National Bank itself. Thus, the target of the nominal Broad Money Supply growth (at the lower limit within the range of 11–15%) corresponds to its real growth of 5–6% (adjusted for the target inflation rate). If the balanced economic growth potential is 1%, a 5–6% increase in the real money supply is excessive, and this clearly contradicts the stabilizing role of monetary policy. One gets the impression that **the National Bank hopes that existing imbalances will resolve by themselves, since the economy has hit a ceiling and is unlikely to continue to grow rapidly even if certain economic incentives are maintained and inflation is restrained by strict price controls, which — at least in 2024 — will not lead to a critical deterioration in the financial standing of firms.**

Interest rates on loans and deposits in Belarusian rubles began to rise in Q4-2023, but remained below their equilibrium (neutral) levels

An average nominal interest rate on new time Belarusian ruble deposits in Q4-2023 increased by 1.1 percentage points versus the average value in Q3-2023, and it reached 5.3% in December 2023: it was the highest rate since August 2022.[vi] The average interest rate on market Belarusian ruble loans increased by 0.7 percentage points in Q4-2023 and reached 9.2% in December 2023.[vii] Thus, interest rates in the credit and deposit market moved away from their historical lows and began to rise from the end of Q3-2023 until the beginning of Q4-2023 against the backdrop of accelerating inflation and Estimated Standard Risk Values increased by the National Bank.

The increase of nominal rates amid accelerating inflation and growing inflation expectations translated into real interest rates on a limited scale. **On average, market interest rates in the Belarusian ruble credit and deposit market remained below their equilibrium levels estimated through QPM** (Figure 3). This means that monetary conditions — in terms of interest rates — remained supportive of economic activity and inflation, but the magnitude of the stimulus slightly decreased towards the end of 2023 (Figure 1).

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

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

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

Rate gap (adjusted for price regulation effect), p.p.
Equilibrium rate on market loans in rubles
Real rate on loans (adjusted for price regulation effect)

Rate gap (adjusted for price regulation effect), p.p.
Equilibrium rate on term deposits in rubles
Real rate on deposits (adjusted for price regulation effect)

Source: The BEROC's calculations are based on the BEROC's Quarterly Projection Model (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).

2 Forex policy: measures, direction, nature

The Belarusian ruble weakened in Q4-2023 amid a reduction in the foreign trade surplus and a seasonal increase in demand for foreign currency

On average, the value of the basket of 3 foreign currencies (Russian ruble, US dollar, Chinese yuan) increased by 2.6% in Q4-2023 versus Q3-2023. In terms of the nominal effective exchange rate, the Belarusian ruble weakened by 2.8% over the same period (Figure 5.b). Foreign exchange rate fluctuations against individual foreign currencies were mainly determined by the dynamics of their cross rates in foreign markets: over Q4-2023 on average, the Belarusian ruble weakened by 1.7% against the US dollar, by 1.9% against the yuan, and by 3.2% 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 $122 million in Q4-2023 (Figure 4.a).

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

a) FX market and foreign currencies basket
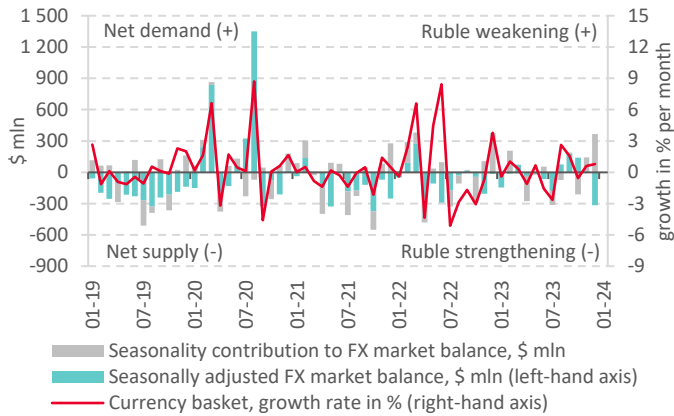
b) international reserve assets (at the end of the period)

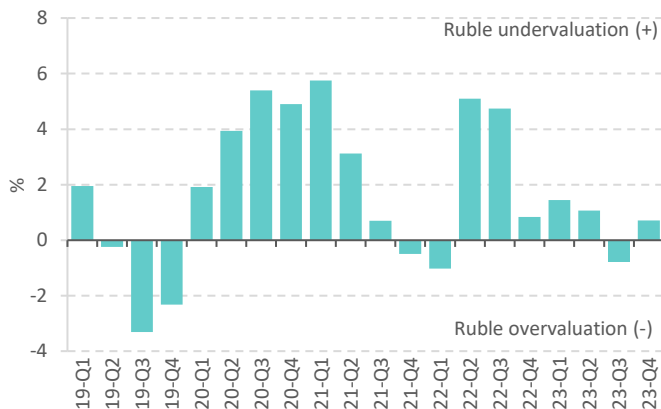**Source:** The BEROC's calculations are based on the data by the National Bank of Belarus.

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 dynamics update once new data are published.

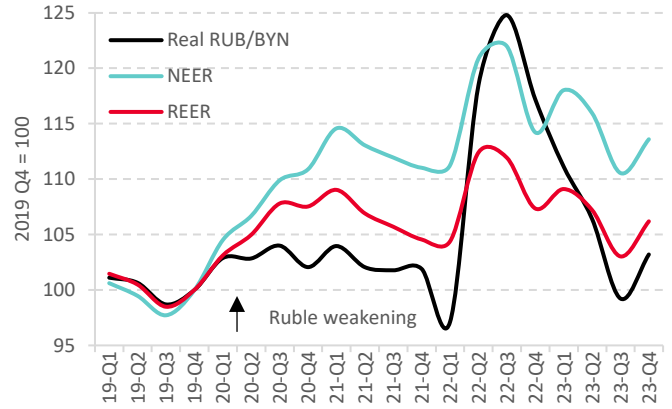## Weakening of the Belarusian ruble neutralized its overvaluation

In terms of the real effective exchange rate, the Belarusian ruble entered the zone of slight undervaluation in Q4-2023 (Figure 5.a), the scale of which can be considered as a close to the neutral exchange rate state for economic activity. In general, support provided to Belarusian exporters by the exchange rate factor dried up in the second half of 2023. The impact of the exchange rate on inflation changed from disinflationary in Q3-2023 to slightly pro-inflationary in Q4-2023: the exchange rate factor did not restrain consumer price growth any longer.

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 BEROC's calculations are based on the data of the National Bank of Belarus and QPM BEROC.

Note: These are the Nominal Effective Exchange Rate (NEER) and the Real Effective Exchange Rate (REER) of the Belarusian ruble.
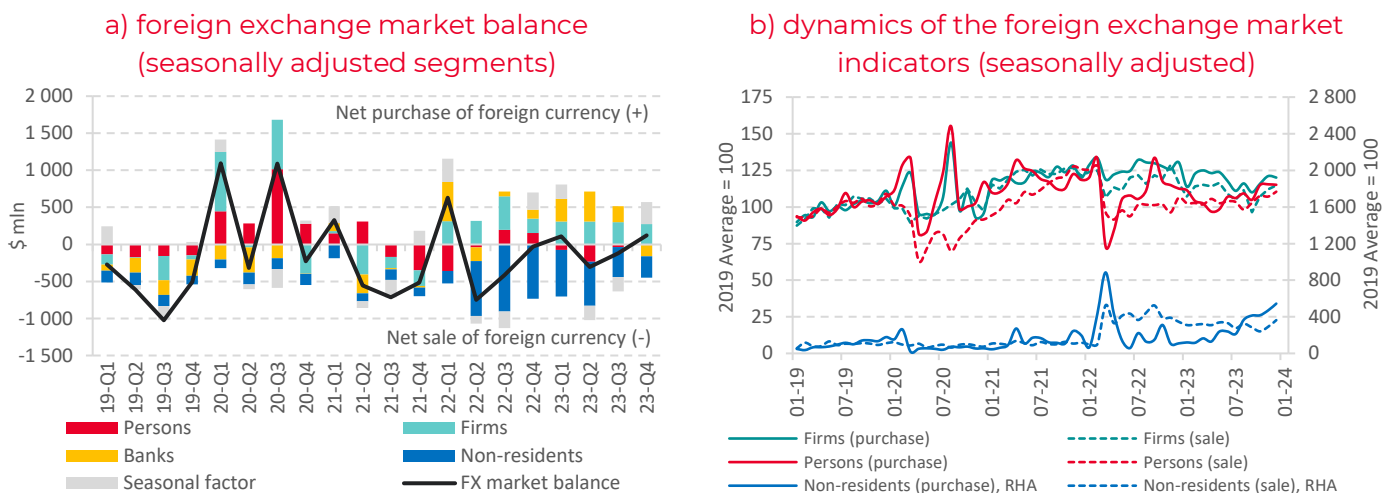
Weakening of the Belarusian ruble in Q4-2023 was caused by net demand in the domestic foreign exchange market associated both with the "neutralization" of the foreign trade surplus and the seasonal factor impact

Net supply of foreign currency by non-residents was decreasing for the fifth quarter in a row: it decreased three times from its peak value in Q3-2022 to approximately $0.3 billion (seasonally adjusted) in Q4-2023 (Figure 6.a).

Net demand for foreign currency from firms continued for the eighth quarter in a row; the size of the demand remained rather stable in 2023 (Figure 6.a). As a result, the total balance of foreign exchange transactions of firms and non-residents was practically zero in Q4-2023 after a significant surplus that had been declining since the beginning of 2023. Such dynamics may reflect a deterioration in the foreign trade in goods and services: after a surplus of more than 6% in 2022, the balance was expected to be near zero in 2023, which was a consequence of the overheating of the Belarusian economy, increased competition in the Russian market, and lower prices for exported Belarusian goods. It cannot be ruled out that the reduction in net sales of foreign currency by non-residents will be affected by the shrinking importance of Belarus as an intermediary country for shadow imports to Russia. A noticeable increase in foreign currency purchases by non-residents started in mid-2023 may also indicate an expanding capital outflow (Figure 6.b).

Forex transactions of households did not pressure the foreign exchange market in Q4-2023: this balance was estimated to be near zero (seasonality adjusted). In the second half of last year, the behavior of households in the foreign exchange market changed: significant net sales of foreign currency gave way to equilibrium in the context of increased wages and soft lending conditions (Figure 6.a). Banks recorded a net sale of foreign currency for the first time since Q2-2022 (Figure 6.a). This correlates with increased issuance of foreign currency loans in Q4-2023, which may signal the end or a noticeable "cooling down" of the process of changing the currency of firms' bank loan liabilities.

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 BEROC's 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.

## International reserve assets (IRA) increased by $202 million in Q4-2023

A rise in the price of gold and an increase in the Special Drawing Rights' (SDRs) exchange rate against the US dollar expanded reserves, as a result of which the value of monetary gold in Belarusian reserves increased by $344 million in Q4-2023, and the US dollar equivalent of SDRs increased by $32 million. The volume of more liquid assets in foreign currencies decreased by $173 million in Q4-2023; this was likely due to the sale of foreign currency by the National Bank. The sufficiency of gold and foreign exchange reserves remained low by the beginning of 2024: their size is estimated at about 2 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. It should be taken into account that part of the reserves in foreign currencies is needed to ensure uninterrupted settlements in Belarus, and it cannot be spent for foreign exchange interventions. Therefore, the scope of resources that can be used to smooth out exchange rate volatility and counter speculative attacks on it is extremely limited. This increases the threat of sharp exchange rate adjustments if shocks affect the Belarusian economy, and this limits the opportunities for pursuing a long-term stimulating monetary policy that supports excess demand and affects foreign trade.

3 Impact of the monetary conditions on the credit and deposit market

Lending activity remained high in Q4-2023, but its growth slowed down in the second half of 2023

The total volume of Belarusian ruble and foreign currency loans issued in Q4-2023 increased, and it was almost 50% higher than the quarterly average in 2021 and 36% higher than in 2022 (Figure 7.a). At the same time, credit impulse (which measures the change in the ratio of newly issued loans to GDP) turned out to be close to neutral in Q4-2023 (Figure 7.b). Lending dynamics indicate that loose monetary conditions continued to support high lending activity, but the expansion of lending slowed down significantly in the second half of the year due to reaching the limit of extensive growth of the Belarusian economy.

Figure 7. Dynamics of new loans issued and credit impulse
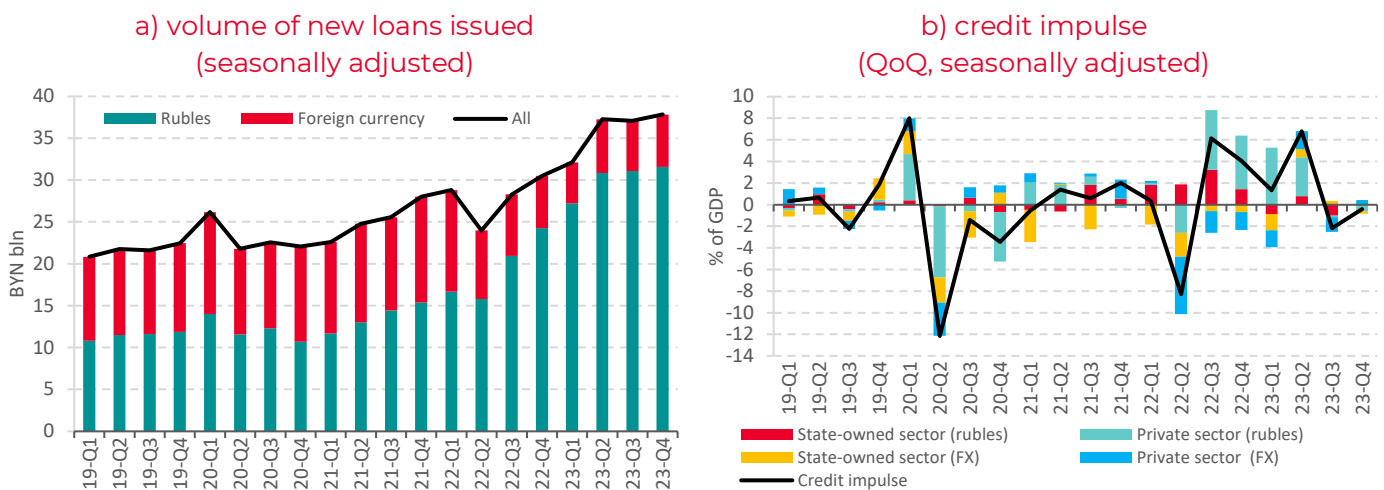
a) volume of new loans issued (seasonally adjusted)

b) credit impulse (QoQ, seasonally adjusted)

Source: The BEROC's 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.

In Q4-2023, credit debt continued to grow at a high rate amid significant issuing of new loans

The growth in the total credit debt of firms and households in Belarusian rubles and foreign currencies remained high (Figure 8.b). In Q2-Q4-2023, debt (calculated at a fixed rate) steadily grew by 4% per quarter on average in nominal terms or by 2.6% in real terms. For comparison, during the recovery period in 2017–2018, the growth of the loan portfolio was estimated at about 1.6% per quarter on average in nominal terms, and at 0.4% in real terms; and in 2019, it was estimated at 2.6% per quarter on average in nominal terms, and at 1.5% in real terms.

There was a slowdown in lending dynamics in the Belarusian ruble segment (Figure 8.a) and an acceleration in lending dynamics in foreign currencies in Q4-2023. This may indicate a fading process of changing the currency of corporate liabilities. This also means that even the slower growth of Belarusian ruble lending still had a stimulating effect on demand in the Belarusian economy in Q4-2023, since a smaller share of this growth is explained by a "technical" change in the currency of liabilities.

Figure 8. Dynamics of bank loan stocks (quarterly growth, seasonality adjusted)
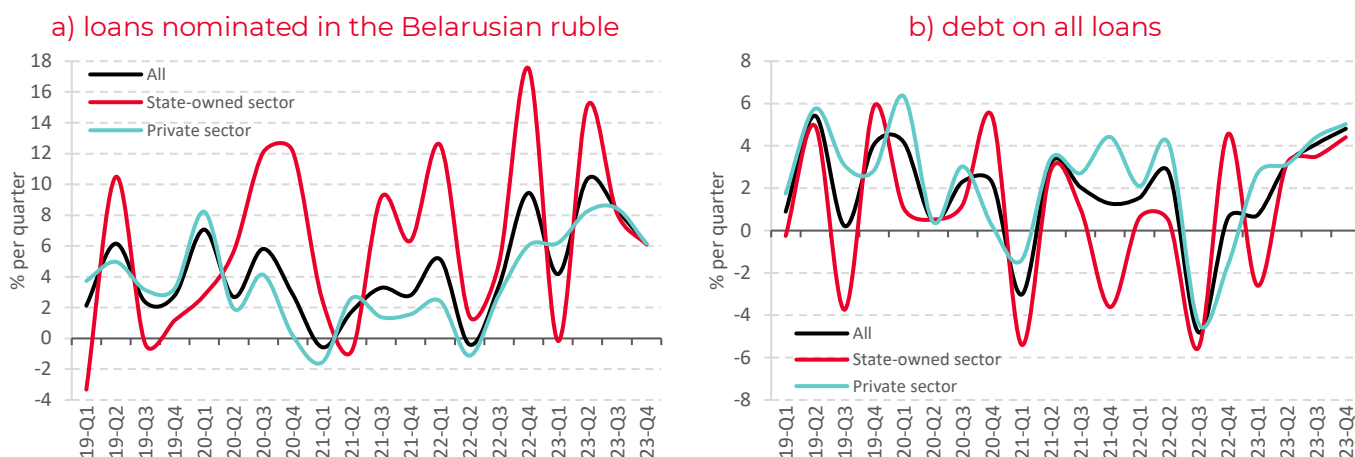
a) loans nominated in the Belarusian ruble   b) debt on all loans

Source: The BEROC's 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.

Money supply continued to grow at a high rate in Q4-2023 (Figure 9.a)

Broad Money Supply (M3) increased by ≈3.3% in nominal terms or by ≈1.1% in real terms in December 2023 versus September 2023 (all indicators are seasonally adjusted). Money supply growth slowed down amid weakening credit impulse in the second half of the year and the fading of rapid GDP growth by the end of the year, but it still exceeded inflation-neutral rates (which correspond to changes in potential GDP and the equilibrium velocity of money). As a result, the volume of real M3 on average in Q4-2023 could deviate by more than 10% from the inflation-neutral level, which is one of the indicators of excessive looseness of monetary policy last year and the presence of an inflationary overhang in the economy.

Broad money growth continued to be driven by the growth of the Belarusian ruble component, but foreign currency deposits also slightly increased in Q4-2023 (Figure 9.b)

In Q4-2023, the Belarusian Ruble Money Supply (M2*) grew by ≈6.5% in nominal terms or by ≈4.3% in real terms (Figure 9.a). The maintenance of high growth of M2* was facilitated by growing liabilities and by expanding issuing operations of the National Bank in Q4-2023.

Figure 9. Average money supply dynamics (seasonally adjusted)

a) real money supply dynamics

b) decomposition of the nominal M3 growth
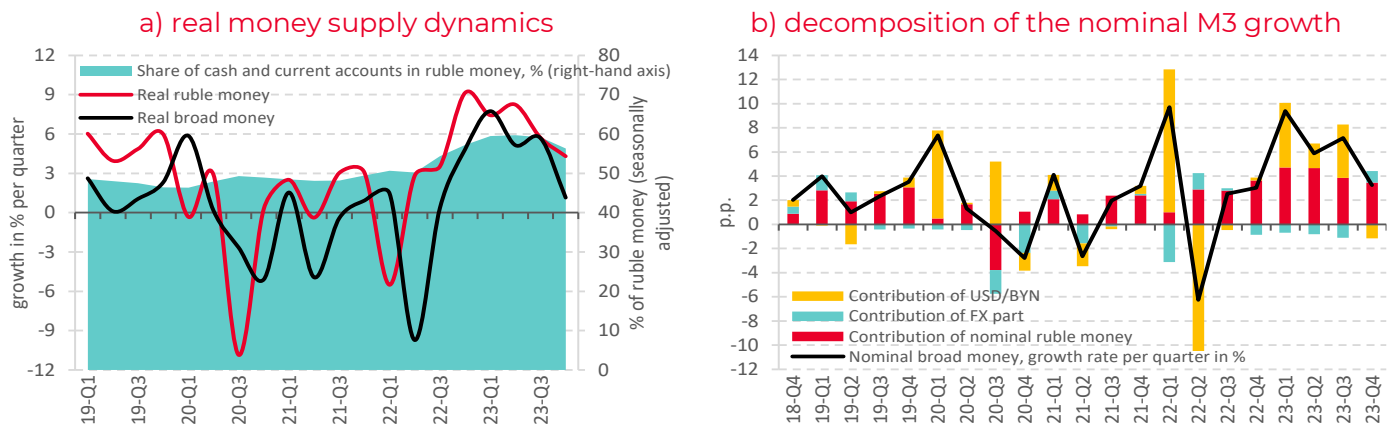
Source: The BEROC's calculations are based on the data by the National Bank of Belarus, Belstat.
Note: The X13 procedure in the JDemetra+ app was applied to make a seasonal adjustment. The indicator dynamics updates once new data are published. The real money supply growth has been calculated by deflating 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 A short-term forecast of monetary conditions

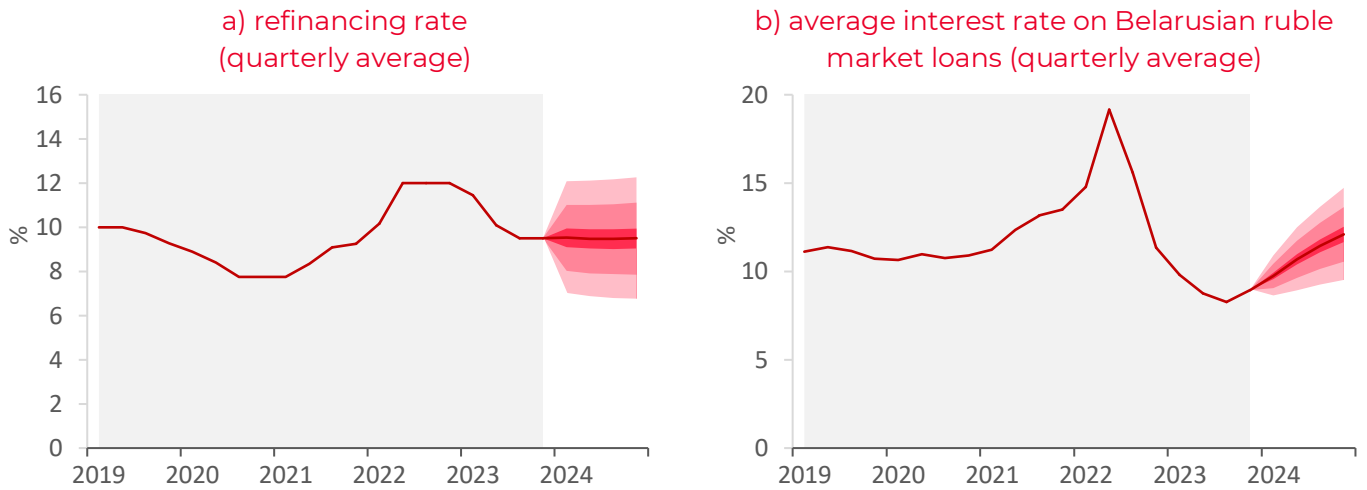## The scale of monetary stimulus ensured by market interest rates may decline in 2024

In economic policy, there are signs of a shift in the authorities' emphasis from excessively stimulating output growth to containing inflation. The likelihood of achieving the 3.8% target of GDP growth in 2024 is extremely low due to the exhausted capacity for recovery growth, the low potential for balanced growth (no more than 1% per year), and the record-breaking production capacity occupancy rate achieved in the second half of last year.

Pro-inflationary pressures, in turn, increased noticeably at the end of last year due to increased costs amid overheating economy and shortage of workers. During election years, the costs of high price increases for the authorities may outweigh the extremely dubious benefits of maintaining high GDP growth. The latter can only occur in the short term, and this will be accompanied by the accumulation of macroeconomic imbalances: further imbalance of supply and demand, increased price pressures, and deterioration of the foreign trade position.

In the baseline scenario, it is assumed that **the National Bank will continue to use indirect tools to influence interest rates on Belarusian ruble market loans and bank deposits in an environment of growing inflation threat and risks of overheated demand for macroeconomic stability.** Estimated standard risk values are very likely to gradually increase, which will allow banks to increase the cost of market lending for businesses and households. A further increase in reserve requirements in order to withdraw excess liquidity from the banking system cannot be ruled out. An extremely cautious gradual increase in the overnight deposit rate accompanied by a corresponding increase in the interbank rate is possible. An aggressive increase in the interbank rate may be undesirable for the authorities, since in this case, a sharp tightening of lending conditions for private businesses and households is likely.

As a result **, the average interest rate on market loans is projected to increase from 9.3% in December 2023 to 10–12% during 2024** (Figure 10.b), and the average interest rate on new time deposits to increase from 5.3% to 7–9%, respectively. This will mean a consistent narrowing of the degree of stimulating impact of interest rates on economic activity, and the interest rates are likely to reach their neutral levels by the end of 2024 (Figure 1).

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 BEROC's calculations are based on the BEROC's Quarterly Projection Model (QPM).
Note: The ranges in the figure correspond to the 15%, 50% and 75% confidence intervals.

In 2024, the refinancing rate will remain at 9.5% (if there are no heavy shocks), and the public sector will retain its preferential conditions of accessing credit resources

The direct effects of rising market interest rates will mainly be faced by private businesses and households. The public sector is "hedged" against the risk of changes in market lending conditions by enjoying access to directed financing. It is highly likely that the authorities will continue to actively use this tool to camouflage structural problems in the economy and counter output decline. Tightening market lending conditions on the one hand and the active directed lending practice on the other will lead to decreasing efficiency of the economy as a whole, as well as the decreasing effectiveness of monetary policy and dropping efficacy of its transmission mechanism, in particular.

Figure 11. Belarusian ruble exchange rate forecast (QPM-based)
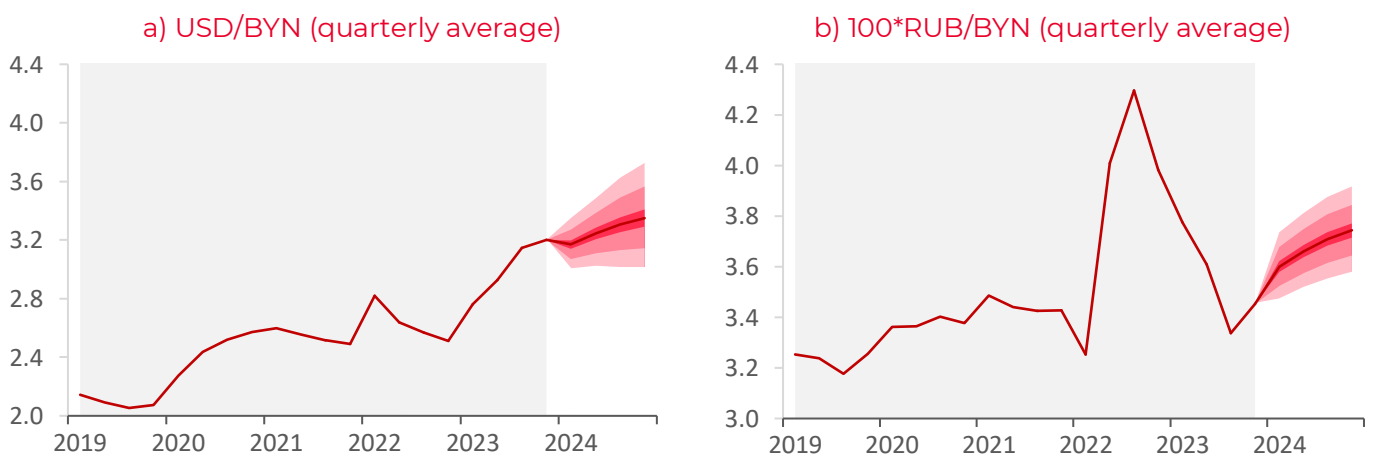
a) USD/BYN (quarterly average)

b) 100*RUB/BYN (quarterly average)

Source: The BEROC's calculations are based on the BEROC's Quarterly Projection Model (QPM).
Note: The ranges in the figure correspond to the 15%, 50% and 75% confidence intervals.

Under the baseline scenario, a moderate weakening of the Belarusian ruble is projected within 10% of the foreign currency basket

An increase in interest rates on market loans and bank deposits will lead to "cooling" retail demand: the growth of household consumption and business investment activity will slow down in 2024. Continued practice of directed lending to the public sector and the likely use of budgetary tools will slow down the rate of return of the economy to an equilibrium state.

As a result, the baseline scenario expects the output gap to remain positive on average in 2024. This would mean that excess demand remains moderate. Considering an increased competition in the Russian market, as well as transport, logistics and production limitations, such economic development may lead to the deficit build-up in foreign trade in goods and services in 2024. If there are no major shocks, the size of the deficit is projected to be moderate: within 1% of GDP; however, this will put pressure on the weakening of the Belarusian ruble versus the foreign currency basket. The dynamics of the Belarusian ruble exchange rates against individual foreign currencies will depend on the trajectory of cross exchange rates in foreign markets (Figure 11).

Stepping out of the monetary policy rules and the situational nature of economic policy in general are significant factors for the forecast's uncertainty

Monetary policy remains discretionary, and the National Bank's room for maneuver in using monetary tools to influence inflation, regardless of the government, is extremely limited. The horizon for forecasting and planning economic policy measures has narrowed to several months or quarters. Policy priorities and quantitative targets, especially those regarding inflation, have been constantly adjusted, and they are not always communicated clearly and unambiguously. Therefore, the government takes ad hoc decisions depending on the current economic situation and voluntaristic attitudes.

One should not rule out maintaining extremely strict price controls and a noticeable tightening of market lending conditions in an attempt to limit inflation to 4-5% in 2024. If this scenario materializes, interest rates will be higher than forecasted under the baseline scenario, and the rate of weakening of the Belarusian ruble will be lower. At the same time, the financial standing of organizations in this scenario may deteriorate so much that in 2025–2026 a sharp change in the economic policy vector will be required to smooth out the negative consequences of probable macroeconomic destabilization.

There is another option of keeping economic policy focused on achieving the target GDP growth rate of 3.8% by any means in 2024, including through an excessively loose monetary policy. In this case, economy overheating will exceed 5% by the end of 2024, which will significantly reduce its resilience to shocks, increase the likelihood of a price surge, a large-scale output decline, and the necessity to aggressively tighten monetary conditions in 2025–2026. If the situation develops 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 an inevitability more significant depreciation of the Belarusian ruble, including its depreciation against the Russian ruble, than the baseline scenario assumes

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. There is a positive fact: currently, the exchange rate regime is much more flexible compared to the period before 2015, and the exchange rate of the Belarusian ruble was close to equilibrium at the beginning of 2024. Therefore, such sharp and large-scale exchange rate adjustments as they were in 2011 and 2015 are not expected even if negative scenarios materialize. Positive risks for the Belarusian ruble exchange rate remain as before: full recovery of exports of key goods (fertilizers, petroleum products, wood products) and stronger growth of the Russian economy.

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. The QPM used in the preparation of this material has been developed by the BEROC experts. See: Quarterly Projection Model for Belarus: Methodological Aspects and Practical Applications.

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] See details: https://vk.com/video-55173999_456239164.

[iv] See details: https://www.youtube.com/watch?v=l01ZocMfKq4.

[v] See details: https://www.nbrb.by/publications/inflationquarterly/inflationquarterly_2023_4.pdf.

[vi] The nominal average interest rate on new term Belarusian ruble deposits increased from 3.4% on average in Q3-2023 to 4.5% in Q4-2023, including interest rates on corporate deposits, which increased from 2.4% to 3.9%, and interest rates on retail deposits, which increased from 8.6% to 9.3%.

[vii] The nominal average interest rate on new market bank loans in Belarusian rubles increased from 8.3% on average in Q3-2023 to 8.9% in Q4-2023; in particular, interest rates on business loans decreased from 8.0% to 8.8%, and interest rates on retail loans decreased from 10.3% to 10.0%.