# Monetary conditions remained moderately loose in Q2-2024, and the National Bank was late in responding to inflation risks

Real interest rates on loans and deposits remained almost unchanged compared to Q1-2024. Interest rates fell slightly short of neutral levels, which helped meet the economy's high demand for credit, and this supported excess demand in the economy. The Belarusian ruble remained moderately undervalued, which corresponded to small pro-inflationary effects.

Only in July did the National Bank respond extremely restrainedly and not very consistently to the growing inflation threat by using only auxiliary tools. The measures taken will push interest rates higher and allow them to reach neutral levels by the end of the year (Figure 1). This will weaken the dynamics of lending and demand, but the neutral nature of monetary conditions is not enough to return the overheated economy to a balanced state quickly.

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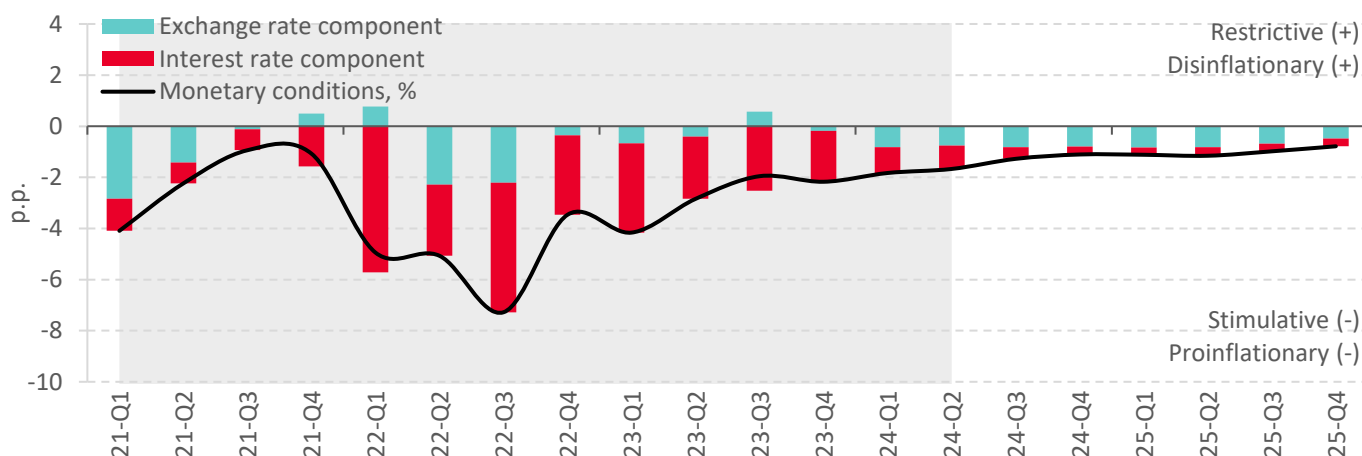
Source: The BEROC's calculations are based on the BEROC's Quarterly Projection Model (QPM) for Belarus.
Note: Monetary conditions are estimated as a combination of deviations of real interest rates on the Belarusian ruble assets and of the real effective Belarusian ruble exchange rate from their equilibrium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

The Monetary Environment Review Bulletin presents an expert analysis of the monetary and foreign exchange rate policies and the resulting monetary conditions in the Belarusian economy. The bulletin reviews the actions under the monetary and exchange rate policies, their impact on the economy, the nature of monetary conditions, and provides their short-term forecast. The methodological basis for the analysis is the Quarterly Projection Model (QPM) for the Belarusian economy. See: WP BEROC no. 82: Quarterly Projection Model for Belarus: Methodological Aspects and Practical Applications.
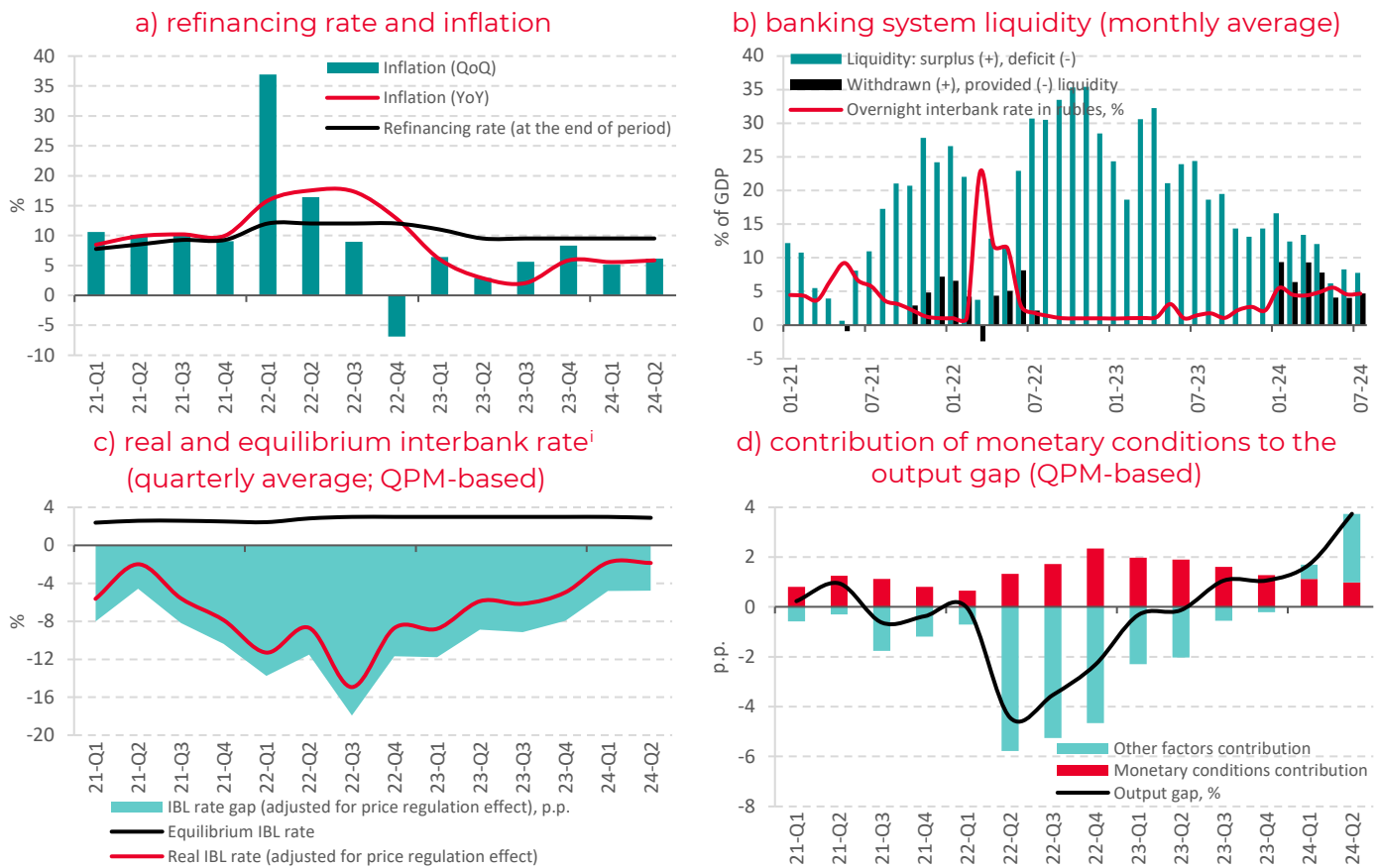
1 Monetary policy: measures, direction, nature

Monetary policy remained accommodative in Q2-2024

The National Bank did not take any active monetary policy steps in April-June 2024: the refinancing rate remained at 9.5% (Figure 2.a), and auction operations were not leveraged to regulate banks' liquidity. The banking system continued to operate in a state of liquidity surplus (Figure 2.b). At the same time, its size decreased due to the sale of foreign currency by the National Bank on the stock exchange and due to more cash in circulation. The excess liquidity was supported by the National Bank's issue of Belarusian rubles through the purchase of government bonds on the secondary market for ≈Br0.6 bn in Q2-2024.

In the context of liquidity surplus and inexistent auction operations of the National Bank, the Interbank Lending Rate (IBL) fluctuated near the lower limit of the National Bank interest rate corridor: it was 5.0% on average in Q2-2024, following 4.8% in Q1-2024 (Figure 2.b). The IBL level (in real terms) also remained almost unchanged in April–June 2024, and it was below its neutral level. Thus, **monetary policy continued stimulating economic activity in Q2-2024, but the size of the stimulus narrowed noticeably versus 2023** (Figure 2.c).

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]

In Q2-2024, monetary policy was still lagging behind and inert in an environment of limited freedom of action of the National Bank

The QPM-based estimates indicate that even with the current system of price regulation, the IBL should have been not close to 5%, but slightly higher than 9% in Q2-2024 in order to mitigate the risks to macroeconomic stability. As a result, loose monetary conditions continued to support excess demand in the Belarusian economy. However, their contribution to the output gap gradually decreased; and increased budget expenditures, high wage growth, and strong demand in Russia played a more important role (Figure 2.d). Inflationary pressure grew in an environment of overheating economy and labor market, and blanket price controls restrained the translation of this pressure into prices. Without the effects of government regulations, annual inflation would have been 10–11% YoY in June, and not 5.8% YoY as it was.[iii]
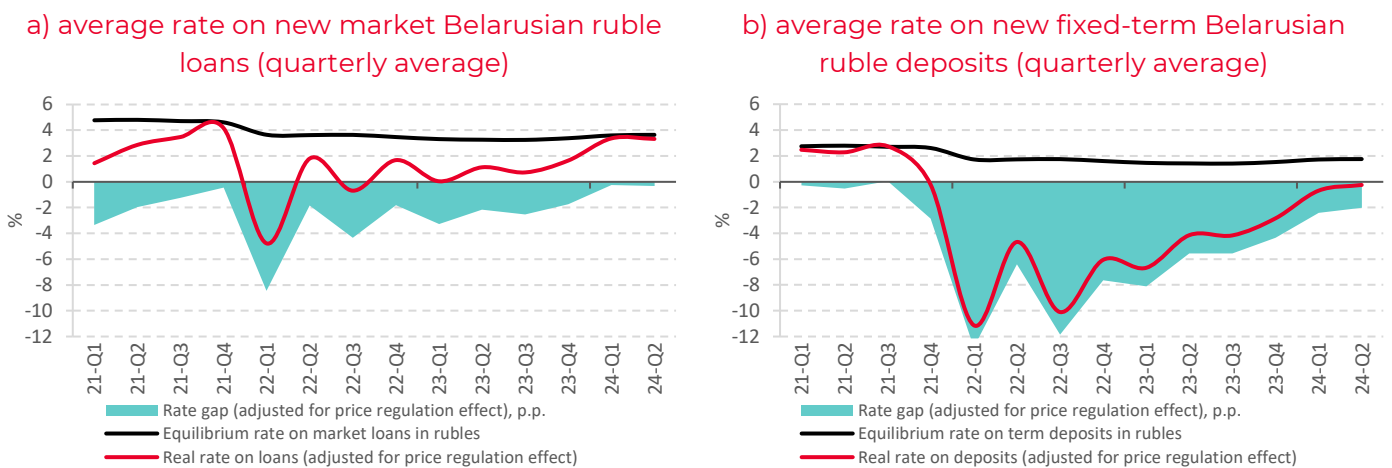
Interest rates on market loans were close to neutral levels in Q2-2024

The average nominal interest rate on new market Belarusian ruble loans grew by 0.2 p.p. — up to 10.2% — in Q2-2024.[iv] In real terms, the interest rate remained close to its level in Q1-2024, which corresponded to its close to neutral nature for economic activity and inflation (Figure 3.a). However, market lending rates are still not restrictive. This maintains favorable conditions for firms and households to satisfy high demand for credit.

Interest rates on Belarusian ruble deposits remained soft on average in Q2-2024

The average nominal interest rate on new time Belarusian ruble deposits grew by 0.7 p.p — up to 6.6% — in Q2-2024.[v] In real terms, the average deposit interest rate remained below the neutral level, which corresponded to its moderate softness (Figure 3.b). Low yields remained in the segment of corporate deposits (6.2% on average in April–June 2024). The interest rate on retail deposits (10.1%) was close to its equilibrium level. This is indicated by the net sale of foreign currency by the population in an environment of high income growth, as well as the historically high share of cash income channeled into time deposits: about 0.9% in Q2-2024, while it was 0.6% on average in 2018-2019.

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 QPM BEROC.
Note: Real interest rates have been calculated based on 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).

Only at the beginning of Q3-2024 did the National Bank respond belatedly in an extremely limited and not entirely consistent manner to higher inflation risks

The overnight loan interest rate increased by 0.5 p.p. to 11% on July 17; the reserve ratio for funds borrowed by banks in foreign currency increased by 2 p.p. to 20% on August 1. The decisions were made on Friday, July 12, which was atypical for the National Bank; and this indicates that its monetary policy was situational. The National Bank refrained from explaining the need for precisely such actions, which emphasized poor quality of its communication policy. The Estimated Values of Standard Risk have also increased by ≈0.5 p.p. for market corporate and retail loans since August, which de facto set the effective upper interest rate limit.

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

Considering part of the free resources that banks need for smooth operations, such a scale of excess liquidity withdrawal will practically neutralize excess liquidity starting from mid-August (provided there are no positive external shocks). In combination with higher Estimated Values of Standard Risk and the overnight loan rate, this should increase the average interbank lending rate and the interest rates on market loans and deposits.

An increase in the interest rate on overnight loans without an increase in the interest rate on overnight deposits indicates that the National Bank is under a heavy administrative pressure as far as the latter benchmark for the cost of money is concerned. The range of interest rates on standing facilities has expanded to 4–11%. If the National Bank does not exercise auction operations, the interbank lending rate will remain volatile. It will be ≈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).

2 Exchange rate policy: measures, direction, nature

The Belarusian ruble weakened slightly in Q2-2024 amid net demand for foreign currency in the domestic market (Figure 4.a)

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

a) forex market and foreign currencies basket   b) reserve assets (at the end of the period)
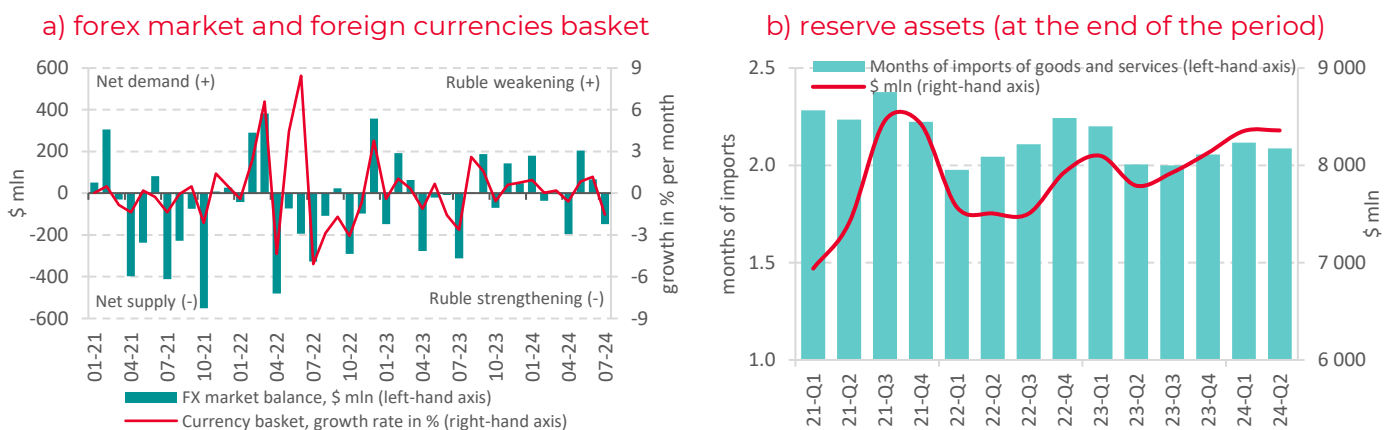
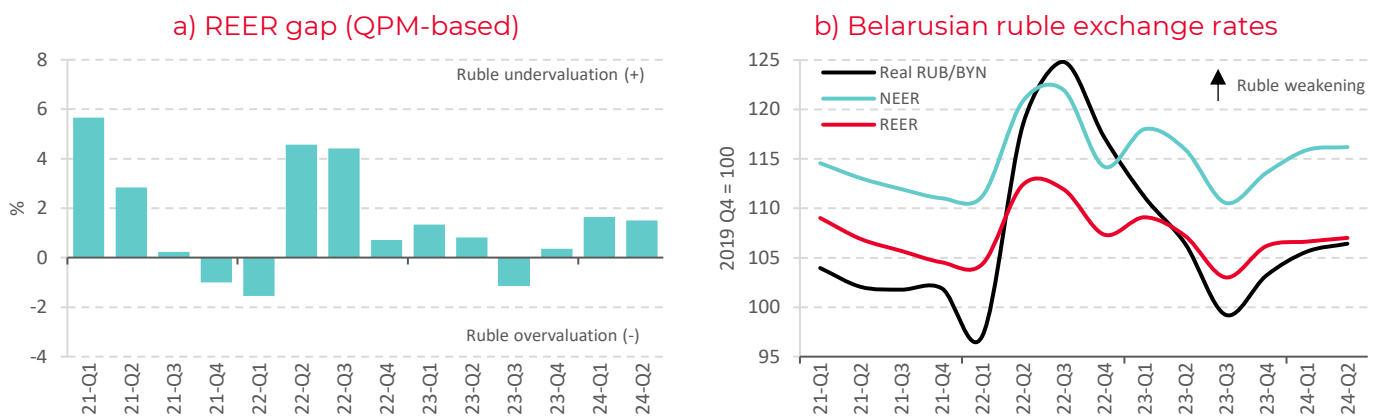**Source:** The BEROC's calculations are based on the data by the National Bank of Belarus.

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

On average, the value of the basket of 3 currencies (Russian ruble, US dollar, Chinese yuan) increased by 0.3% in Q2-2024 vs. Q1-2024. In terms of the nominal effective exchange rate, the Belarusian ruble also weakened by 0.3% over this period (Figure 5.b). Exchange rate fluctuations against individual currencies were mainly determined by the dynamics of their cross rates in foreign markets: over Q2-2024 on average, the Belarusian ruble weakened by 0.3% against the US dollar, by 0.4% against the Russian ruble, and strengthened by 0.5% against the Chinese yuan.

The weakening of the Belarusian ruble kept it moderately undervalued

In terms of the Real Effective Exchange Rate (REER), the Belarusian ruble lost 0.4% of its value on average in Q2-2024. The national currency remained undervalued by about 1.5% versus the equilibrium REER level (Figure 5.a). As a result, the foreign exchange rate factor continued to support the price competitiveness of Belarusian producers. At the same time, the slight pro-inflationary impact of the foreign exchange rate continued.

Figure 5. Effective Belarusian ruble exchange rates and deviations of REER from the equilibrium level

a) REER gap (QPM-based)   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).

Gold and foreign exchange reserves remained virtually unchanged in Q2-2024 and amounted to $8.36 billion as of July 1, 2024

The value of gold that grew by $0.2 bn in Q2-2024 due to its rise in price on the world market was offset by decreased reserve assets in foreign currency. The latter is associated with the public debt repayments and the sale of foreign currency by the National Bank. The sufficiency of reserves remained low at the beginning of Q3-2024: their size maintained at about 2.1 months of imports of goods and services (Figure 4.b), and their most liquid component in foreign currencies – at about 0.7 month of imports of goods and services.

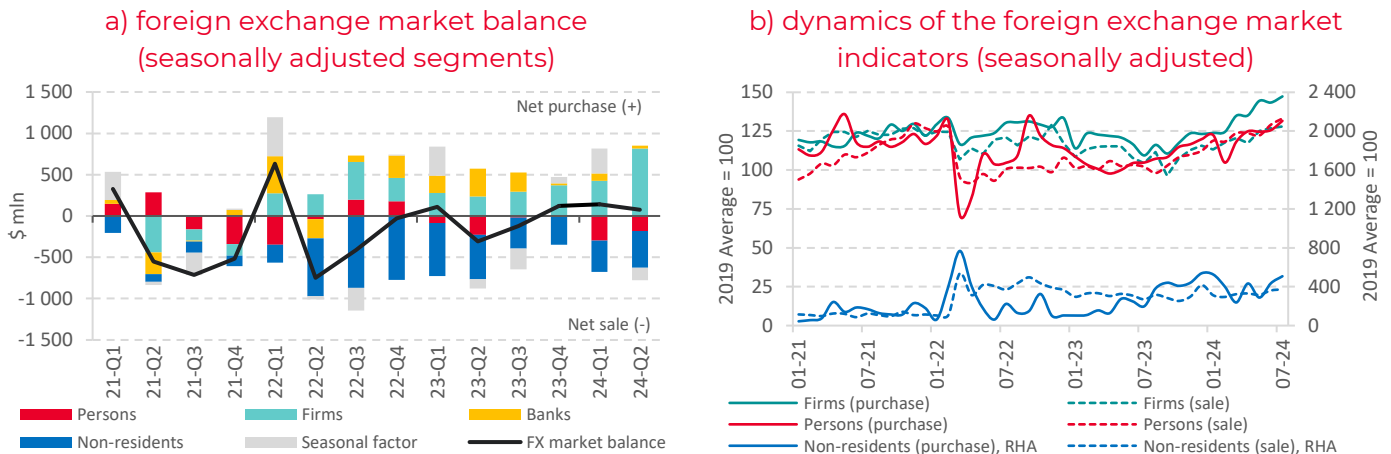**Net demand in the FX market led to the weakening of the Belarusian ruble in Q2-2024**

Net demand amounted to $74 mln in Q2-2024, which, once seasonally adjusted, corresponded to ≈$225 mln (Figure 6.a). The National Bank balanced the market and smoothed out the volatility of the exchange rate through its interventions: its foreign currency sales (balanced with the operations of the Ministry of Finance) amounted to $74 mln in Q2-2024 (Figure 4.a).

Net purchases of foreign currency by resident firms increased significantly (seasonally adjusted), from ≈$0.4 bn in Q1-2024 to a record-breaking volume since 2010: ≈$0.8 bn in Q2-2024 (Figure 6.a). The net demand of firms was partially offset by growing net sales of currency by non-residents, which likely reflects settlement schemes in foreign transactions that have changed after 2022. However, the total net purchase of currency by resident firms and non-residents has almost reached ≈$0.4 bn (Figure 6.a).

Such a strong growth in the net demand of firms for foreign currency indicates a high probability of one-time large purchases of foreign currency by large enterprises. The increase in net purchases could also be influenced by a significant increase in external receivables of enterprises in an environment of close-to-zero balance of foreign trade in goods and services.

The foreign exchange market continued to be supported by the population, which sold $0.18 bn on a net basis (seasonally adjusted) in Q2-2024 (Figure 6.a). The sale of foreign currency by the population in an environment of strong income growth may be associated with increased demand for real estate and savings in Belarusian rubles. This, among other things, was caused by higher risks of investing in foreign currency amid sanctions.

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.

3 Impact of monetary conditions on the credit and deposit market

Demand for credit remained elevated in Q2-2024 in an environment of strong demand for firms' products and high consumer activity

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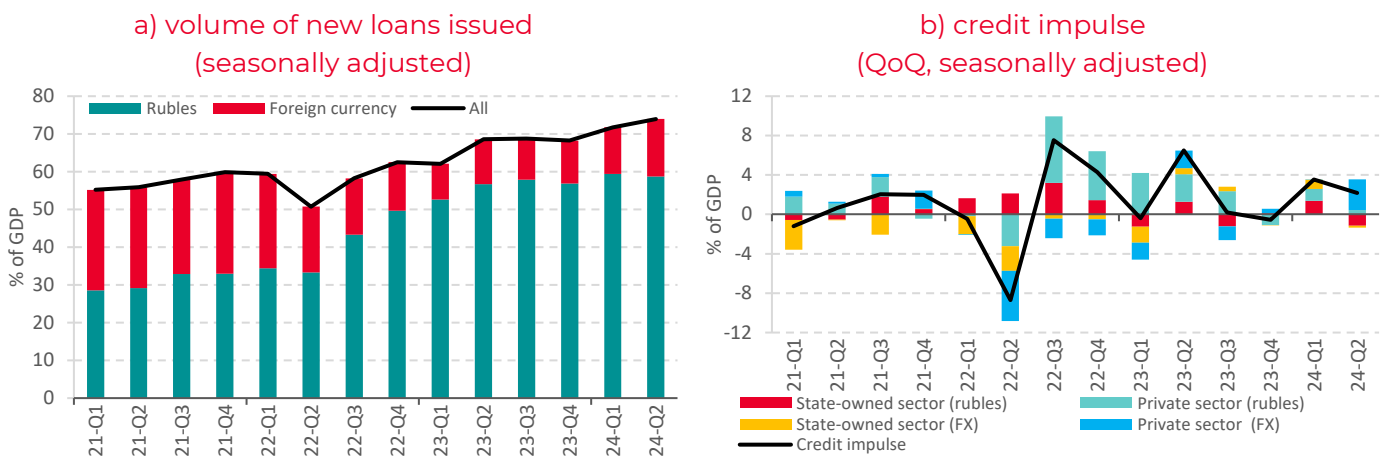
a) volume of new loans issued (seasonally adjusted)

b) credit impulse (QoQ, seasonally adjusted)

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

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

The volume of loans issued exceeded the average level of 2021 by approximately 82%, and reached ≈74% relative to GDP (Figure 7.a). The volume of new lending remained near its multi-year peak value mainly due to keeping extremely high levels of borrowing in Belarusian rubles (Figure 7.a). The issuance of foreign currency loans also increased noticeably in Q2-2024 (Figure 7.b). This may be due to overdue foreign exchange receivables under foreign trade contracts. Loan debt also increased significantly in Q2-2024. High growth was noted in both the public and private sectors (Figure 8).

The non-restrictive nature of interest rates allowed firms and the population to satisfy their increased demand for credit, and the expansion of preferential borrowing programs for households and the preservation of directed lending to enterprises (to do this, the National Bank acquired ≈Br0.6 bn of government bonds by issuing Belarusian rubles in Q2-2024) were additional factors supporting lending activity. At the same time, a reduction in inventories in relation to output, as well as a decrease in the importance of budget resources and preferential loans in financing investments in the first half of 2024 versus 2023 give reason to believe that **the growth in lending in 2024 is mainly associated with the impact of the situational economic conditions, and not with the accelerated financing through issuing money.**

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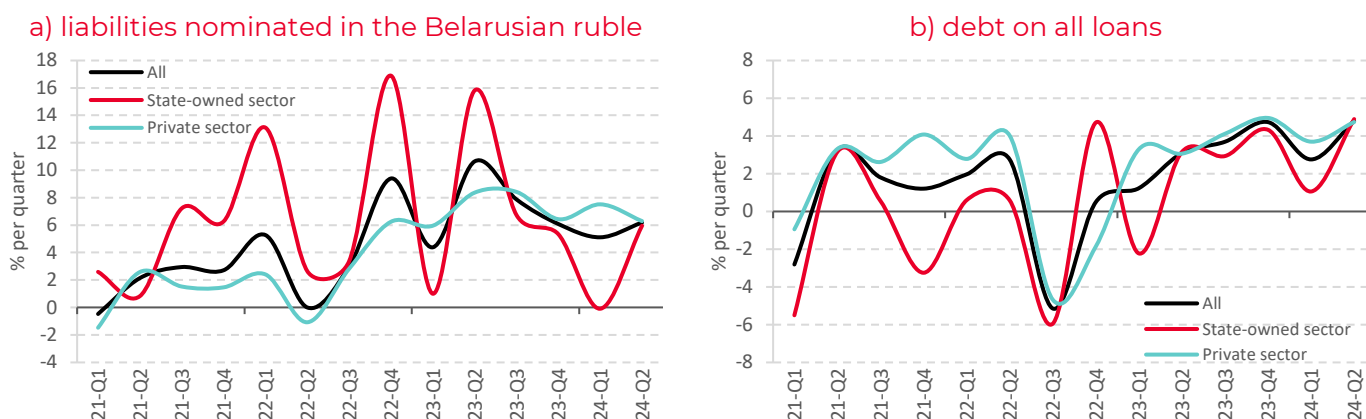
a) liabilities nominated in the Belarusian ruble   b) debt on all loans

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

Money supply was growing at a high rate amid a strong demand for money

Broad Money Supply (M3) grew by ≈4.8% in Q2-2024 in nominal terms (this is the average value for Q2-2024 versus the average value in Q1-2024) or by ≈3.5% in real terms (all indicators are seasonally adjusted). Broad money growth was ensured by the Belarusian ruble component (Figure 9.b), which grew by 6.3% and 5.0% respectively over the same period (Figure 9.a). The foreign currency part of the money supply also increased in Q2-2024 (Figure 9.b), which correlated with the higher volume of loans issued in foreign currency. In Q2-2024, the M3 dynamics roughly corresponded to the nominal GDP dynamics. Since GDP strongly deviated upward from the trajectory of balanced growth (economy overheating intensified in Q2-2024), such money supply growth noticeably outpaced its inflation-neutral rates. Consequently, the National Bank did not follow the rules when pursuing its monetary policy, which was not consistent with either the monetary targeting regime or the inflation targeting regime.

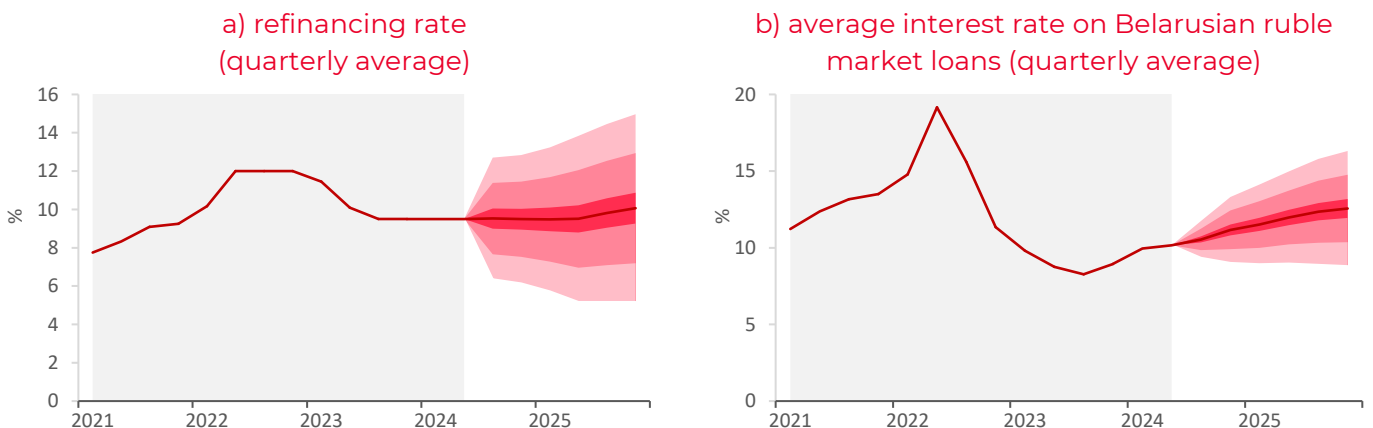Figure 9. Average money supply dynamics (seasonally adjusted)
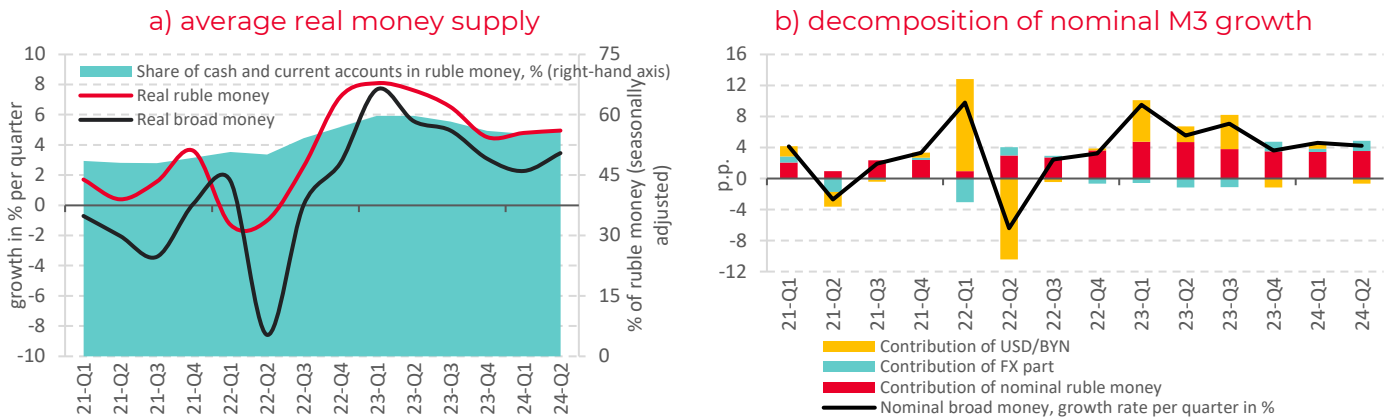
a) average real money supply

b) decomposition of nominal M3 growth

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

4 Monetary conditions short-term forecast

The measures taken by the National Bank in July will lower the stimulating effects of interest rates and bring them closer to neutral levels by the end of this year

The average interbank lending rate may move from 4–6% in the first half of the year to ≈6–8% starting from August-September due to decreasing excess liquidity of banks. The average interest rate on Belarusian ruble market loans may rise from ≈10% to ≈11-12% by the end of the year (Figure 10.b), and the average interest rate on time deposits may rise from ≈6.5% to ≈7.5–8.5%. The range of possible deviations from these estimates is significant due to the wide range of the interest rates set by the National Bank, the likely absence of auction operations and due to the uncertainty of external conditions.

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

The National Bank may take additional measures like increasing the Estimated Values of Standard Risk, credit burden limiters, and, less likely, increasing the interest rates on overnight deposits and loans. However, there is still little reason to believe that the regulator will decide to make monetary policy restrictive in the pressure environment exercised by the executive branch. The National Bank's limited freedom of maneuver will result in maintaining the refinancing rate near the current level of 9.5% in the second half of 2024 (Figure 10.a).

The narrowing of monetary stimulus will contribute to gradually weakening dynamics of lending and domestic demand. However, monetary conditions will not become tight (Figure 1), which — combined with rising budget spending and the persistence of non-market lending — will continue to support excess demand in the economy.

The Belarusian ruble can weaken in terms of a basket of foreign currencies by ≈4% in 2024

Excess demand in the economy will continue to support high volume of imports. The expected weakening of demand dynamics in Russia, increased competition in the Russian market, delays in foreign exchange settlements under sanctions, and the ceiling reached in capacity utilization in the industrial sector will constrain export revenues. Foreign trade in goods and services will develop with a deficit of about 0–1% of GDP in 2024 if there are no heavy shocks. This deficit size corresponds to a moderate pressure on the Belarusian ruble exchange rate, which may intensify towards the end of the year. As a result, the Belarusian ruble can weaken in terms of a basket of foreign currencies by about 4% in 2024. The dynamics of the Belarusian ruble exchange rates against individual foreign currencies will depend on the trajectory of cross exchange rates in foreign markets. If the USD/RUB exchange rate is close to 90 Russian rubles per US dollar, the USD/BYN exchange rate will be 3.23 Belarusian rubles per US dollar on average in 2024 (Figure 11.a). In this case, the exchange rate of 100*RUB/BYN is projected at 3.57 Belarusian rubles per 100 Russian rubles on average in 2024 (Figure 11.b).

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

Figure 11. Belarusian ruble exchange rate forecast (QPM-based)
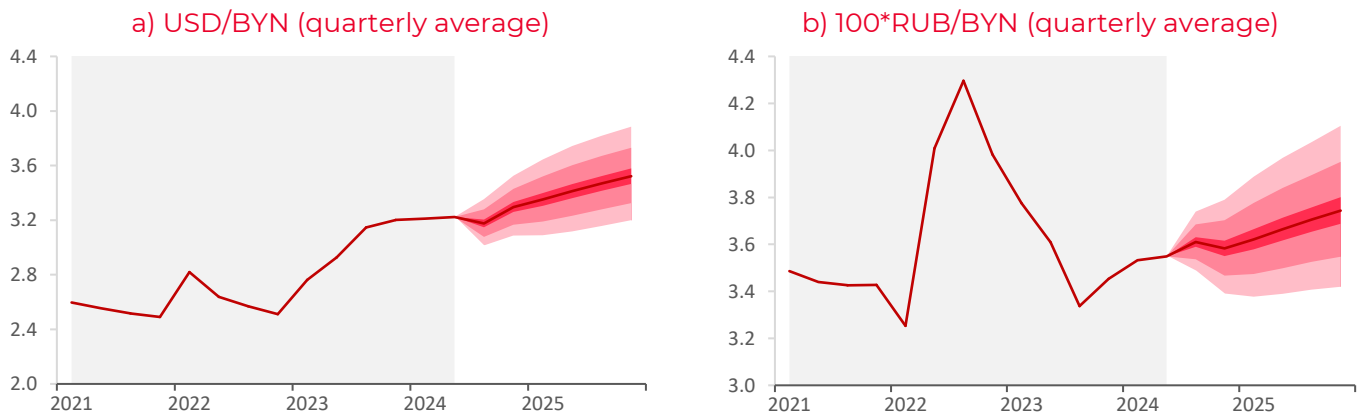
a) USD/BYN (quarterly average)   b) 100*RUB/BYN (quarterly average)

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

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-Q4-2023 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] For more information about the dynamics, factors and projections of inflation processes in Belarus, see: BEROC (2024) Inflation Review: Q2-2024.
URL: https://beroc.org/upload/medialibrary/07b/07b04c8e61e9840c35c3b21e718d2ede.pdf.

[iv] The nominal average interest rate on new market bank loans in Belarusian rubles increased from 10.0% on average in Q1-2024 to 10.2% in Q2-2024; in particular, interest rates on business loans decreased from 9.9% to 10.2%, and interest rates on retail loans remained at 10.0%.

[v] The nominal average rate on new term Belarusian ruble deposits increased from 5.9% on average in Q1-2024 to 6.6% in Q2-2024, including interest rates on corporate deposits, which increased from 5.4% to 6.2%, and interest rates on retail deposits, which increased from 9.7% to 10.1%.