

Express Analysis

Economic activity and inflation

December 2023

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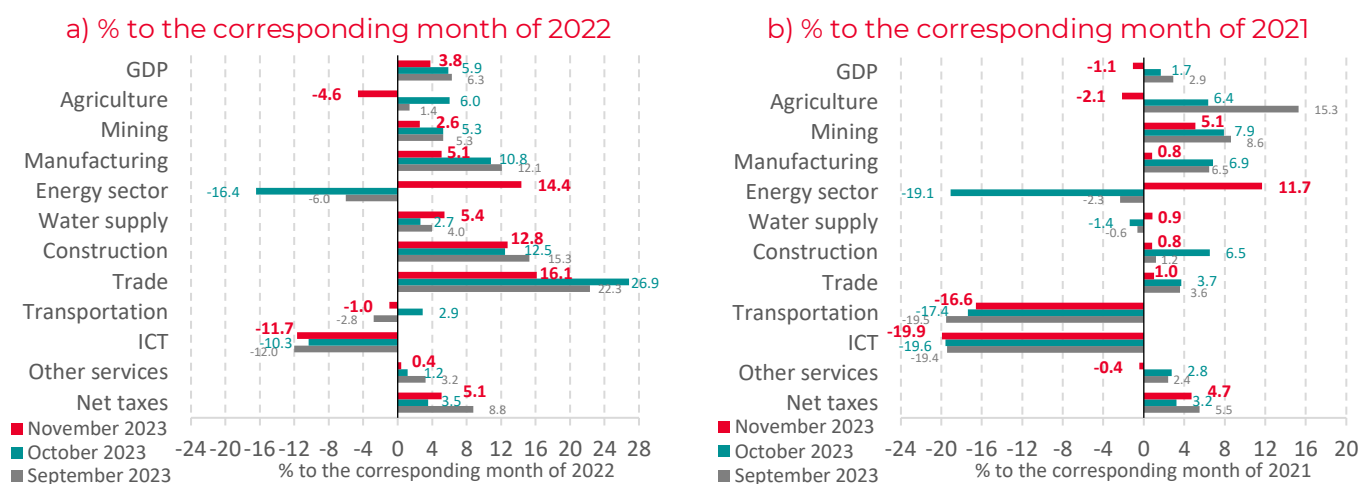
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Extensive growth of the Belarusian economy hits its ceiling due to production capacity limitations

Belarusian GDP grew by 3.8% (YoY) over 11 months of 2023, including a $\approx 3.8\%$ growth (YoY) in November 2023 (Figure 1.a). GDP (seasonally adjusted) remained above its equilibrium level in November 2023, but it fell by more than 1% versus October 2023. The space for high extensive growth is being exhausted due to supply limitations: lack of staff, lack of production capacity, and complexity of logistics. In the current situation, continuation of the expansionist economic policy will lead not so much to rapid output growth, but to accelerating inflation and expanding foreign trade deficit.

At the end of the year, GDP growth will be around 3.8–4% (YoY), and it will slow down to the range of 0–2% (YoY) in 2024, if there are no significant shocks. In 2024, the trajectory of the economy will largely depend on the decisiveness of the National Bank's actions. The measures taken by the National Bank in December 2023 will prevent loosening monetary conditions. However, in an environment of accumulated inflation overhang and continued directed lending, monetary tightening will be needed to limit price increases.

Figure 1. Growth in GDP and value added of sectors in Belarus



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

This Express Analysis is an operational analysis of the status of the most important macroeconomic indicators of Belarus.

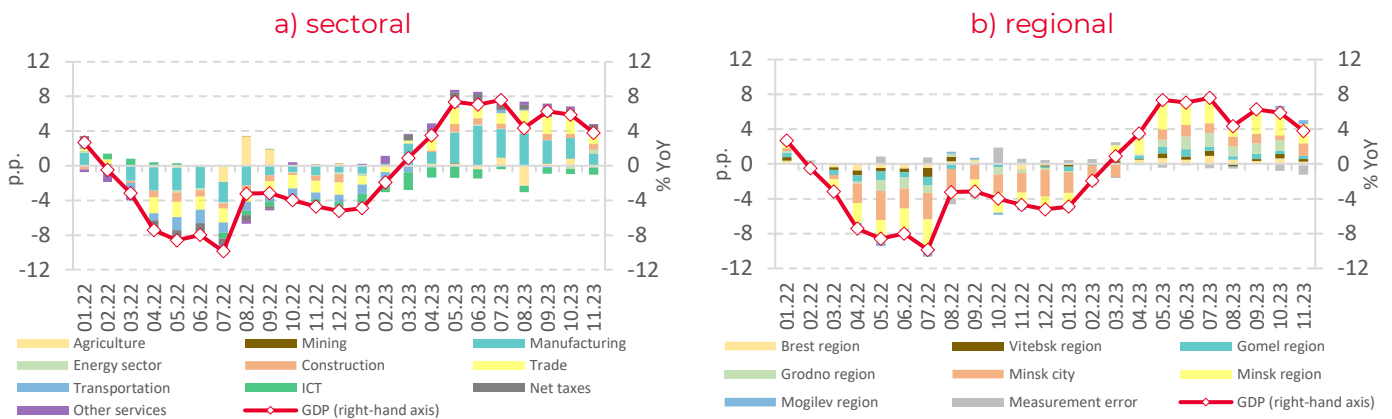
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Value added growth in the manufacturing decreased by more than half to $\approx 5.1\%$ (YoY) in November (Figure 1), and its contribution to annual GDP growth decreased to ≈ 1.3 p.p.

The output (seasonally adjusted) of manufacturing and processing industries decreased noticeably in November versus October (Figure 3.a). Production stagnated in the Grodno region, decreased in other regions, and dropped most significantly in Minsk. The trajectory of exports of goods to the CIS countries indicates stagnation in the physical volumes of supplies to Russia (Figure 5.a), which may reflect the output dynamics in the machine-building, metallurgical and food complexes. Oil refining, fertilizer production and, possibly, wood processing have reached their high capacity utilization levels, and they are close to exhausting the room for growth in the current supply logistics configuration. This is indicated, among other things, by reduced wholesale values (seasonally adjusted) in October-November after their strong growth in August-September (Figure 3.a). Overall, manufacturing output has fallen in real terms from its September-October peaks, and production capacity utilization remained near a record level of 70% through the autumn months.

Industrial output may remain high in the near term if loose domestic economic policy and strong budget stimulus in Russia are continued. However, **prospects for rapid growth have reached their limit, and further growth will be increasingly constrained by supply.**

Figure 2. Structure of GDP growth in Belarus (given month compared to the corresponding month of the previous year: % (YoY))



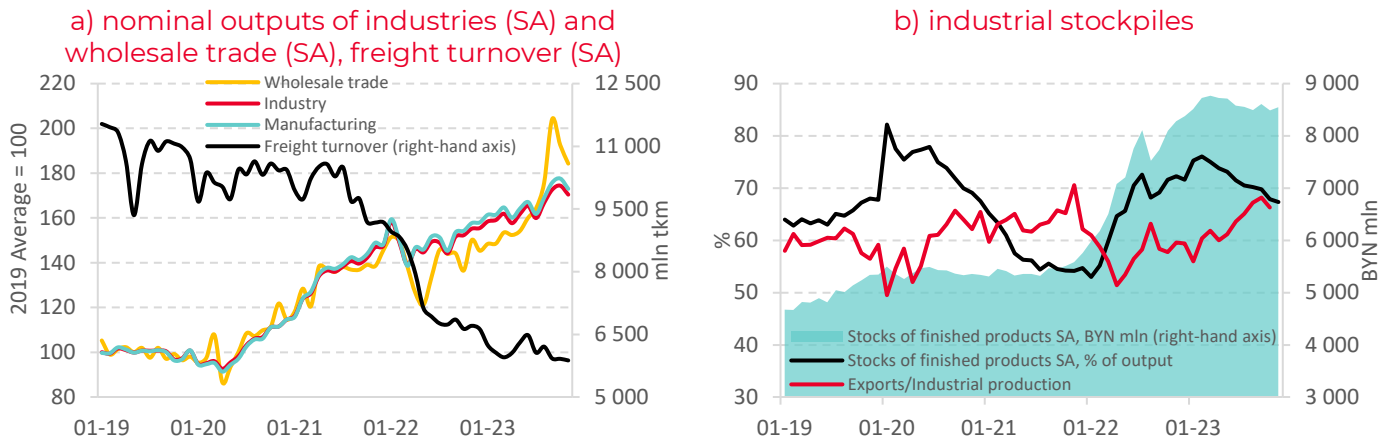
Note: The estimates update once the data are verified. The energy sector includes water supply.

The construction and service sectors showed restrained output dynamics in the autumn months: the shortage of workers limits growth prospects, and this is reflected in a strong rise in real wages (Figure 4.a)

Investments (seasonally adjusted), including investments in construction, decreased in November versus October (Figure 4.b). Weak development incentives and a shortage of labor resources constrain investment activity despite continued soft market lending conditions and directed financing.

The dynamics of value added in services (except for trade, transport and ICT) has weakened over recent months (Figure 1.a). Labor costs make up a significant share of production and service costs. For this reason, the shortage of workers creates significant risks of weakening activity in the sector even if stimulating domestic economic policy continues.

Figure 3. Output and stockpile dynamics in manufacturing industry

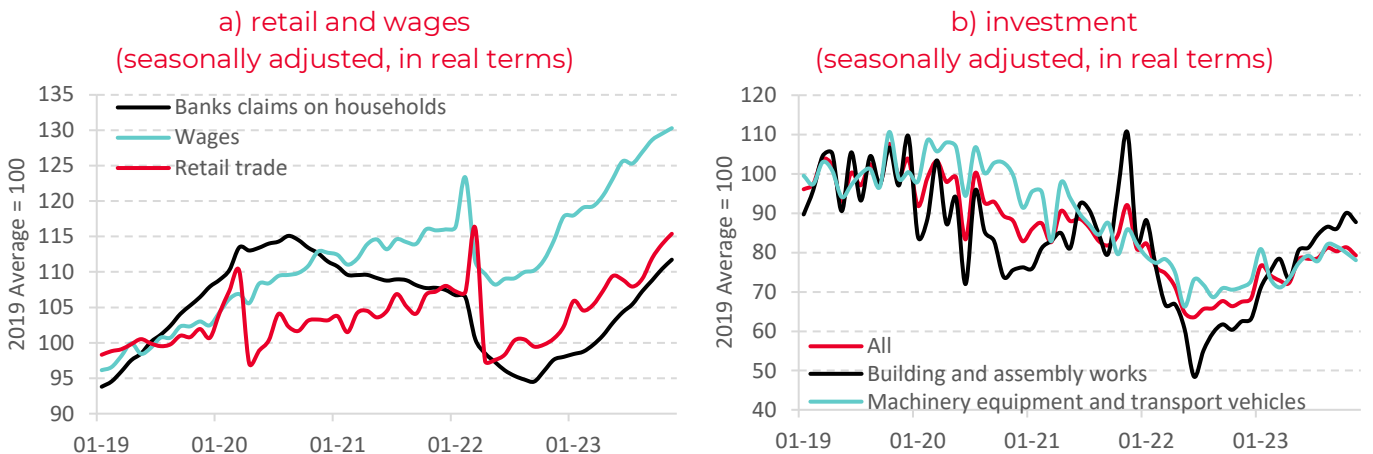


Note: SA is a seasonally adjusted indicator. The dynamics update once new data are published.

Consumer demand has continued to expand at a rapid pace, but in the context of labor shortages and limited production capacity, rapid demand growth cannot ensure sustainable output growth

Retail turnover (seasonally adjusted) continued to grow in November, and in real terms, it was almost 10% higher than the average monthly turnover in 2021 (Figure 4.a). Consumer activity has been stimulated by loose lending conditions and rising wages. Consumer activity will remain high and overheated in the coming months due to the inertia of the impact of these factors on demand. In 2024, consumption dynamics will weaken due to the projected increase in interest rates on market loans and a slowdown in wage growth.

Figure 4. Retail trade and investment dynamics



Note: The real volume of retail trade has been calculated by deflating the nominal retail trade volume by the Consumer Price Index for food and non-foods. A real wage has been calculated by deflating a nominal wage by the Composite Consumer Price Index. Real investment indicators have been calculated by deflating nominal investment by construction price indices. Seasonal adjustment has been made by using the X13 and TRAMO/SEATS procedures in the JDemetra+ software application. The indicator dynamics updates once new data are published.

Freight transportation shows no signs of recovery

In November, freight turnover (seasonally adjusted) continued to stagnate being at its recent years' lows: minus $\approx 40\%$ versus the average monthly turnover in 2021 (Figure 3.a). There are no prospects for a quick recovery in the sector in the context of reduced transit and increased competition from Russian freight forwarders.

The ICT sector shows weak dynamics, close to stagnation

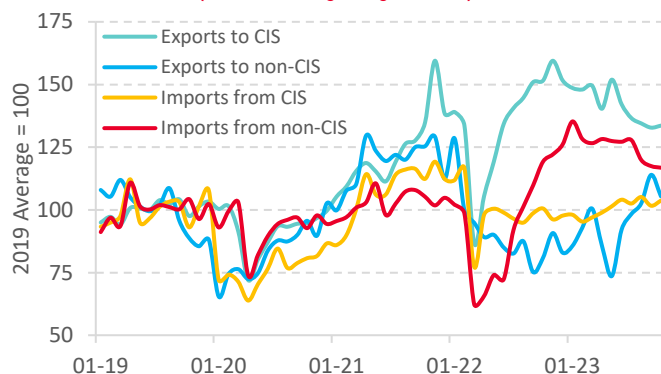
Value added in the ICT sector decreased by $\approx 11.7\%$ (YoY) in October, thus subtracting ≈ 0.8 p.p. from annual GDP growth (Figure 2.a). This decrease is estimated at $\approx 19.9\%$ versus November 2021 (Figure 1.b). In the fall of 2023, the sector showed weaker dynamics than in the fall of 2021, and it was similar to the autumn months of 2022. Given the decline in transit traffic, the weak dynamics of the ICT sector is reflected in preserved values of exports of services at their minimal levels since 2017 (Figure 4.b). **GDP was supported by the energy sector in November** (Figure 2.a) possibly due to the cold last ten days of the month.

The economy loses momentum for growth, but remains unbalanced: demand exceeds supply

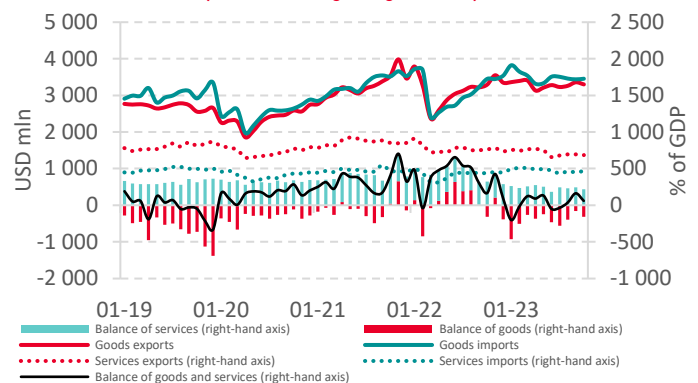
Domestic policy priorities have shifted from maintaining macroeconomic stability to stimulating economic activity. The incentive methods chosen by the authorities (excessively loose monetary policy, expanding directed lending and budget expenditures, administrative impacts) can influence output in the short term only. Their continued application causes an imbalance of supply and demand: overheating of the economy, the scale of which is tentatively estimated at 2-3% of potential GDP in Q4-2023. This, as well as the deterioration in terms of trade, resulted in the balance of foreign trade in goods to get back to a deficit (Figure 5.b) and in an increased threat of further deterioration in the external position and inflation.

Figure 5. Dynamics of foreign trade indicators

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



b) value volumes of foreign trade (seasonally adjusted)



Note: The X13 procedure in the JDemetra+ app has been applied to make a seasonal adjustment. The dynamics update once new data are published.

Inflation accelerated in November: annual increase of consumer prices grew from 3.7% (YoY) in October to 5.4% (YoY) in November 2023

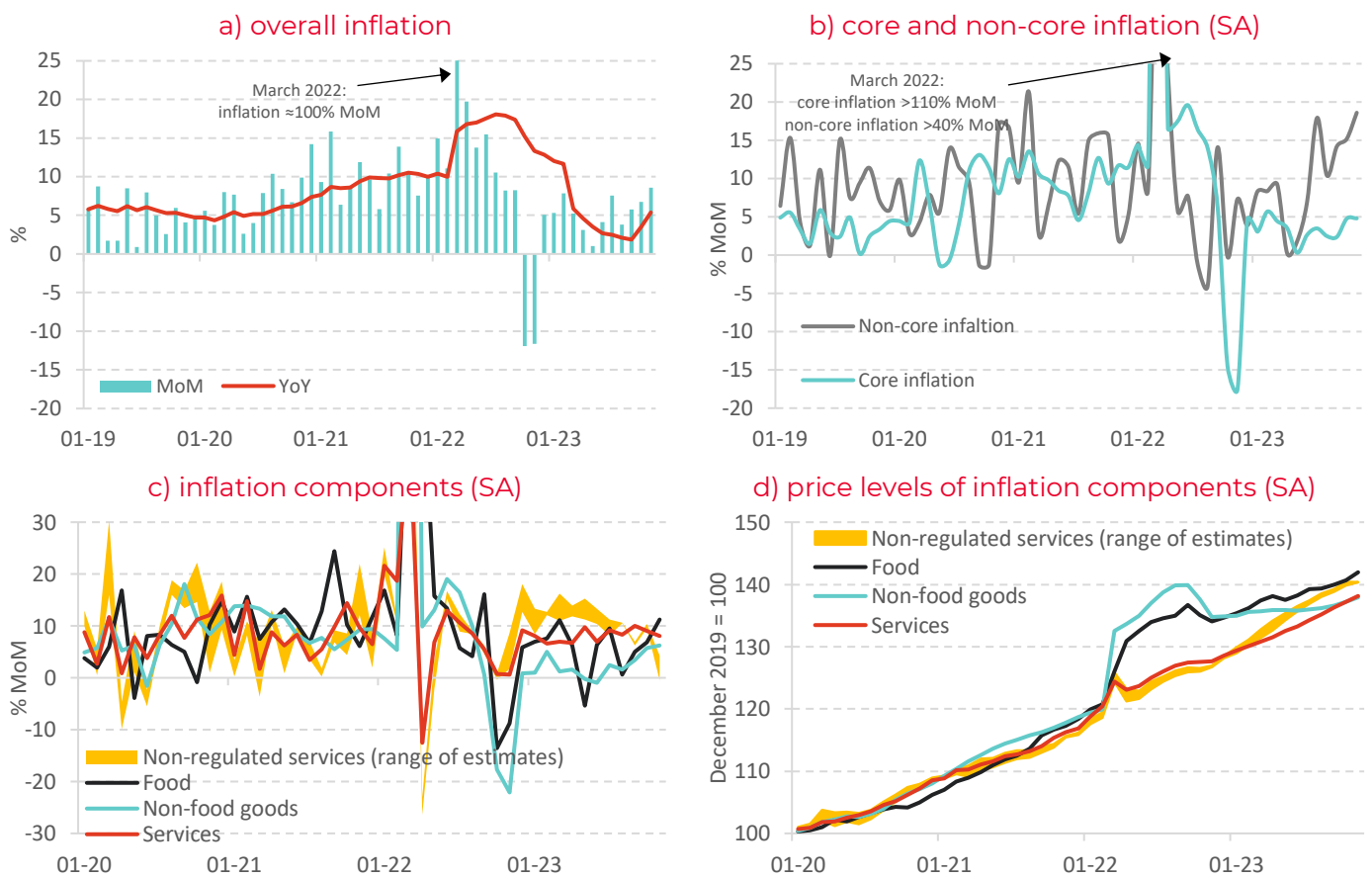
Annualized monthly inflation (seasonally adjusted) increased to 8.5–9% (MoM) in November (Figure 6.a). Price pressure intensified in the segment of non-core inflation: both the growth of administratively regulated prices and tariffs and prices for fruits and vegetables accelerated (Figure 6.b). Higher prices for vegetables and fruits can be due to deterioration in the quality of the crop this year, due to the transfer of the weakening Belarusian ruble against the US dollar and euro to the prices, and, possibly, because exports are of higher priority than domestic market sales. An accelerated increase in regulated prices may signal increasing cost pressures in an overheated economy.

Annualized core monthly inflation (seasonally adjusted) remained close to 5% (MoM) in November. Price increases, especially for non-food products (Figure 6.c), continue to be limited by strict government price controls. Furthermore, extremely volatile prices for tourism services fell sharply in November, which not only contained core inflation, but also slowed inflation down in unregulated services (Figure 6.c). The prices for services associated with a high share of labor costs (in-home services, cultural and sports services, medical services, unregulated utility services, training courses) continued to grow at a high pace. This indicates pro-inflationary pressure from the labor market (shortage of workers) and excess demand in the economy.

Annual inflation will be around 5.5–6% (YoY) by the end of 2023

Prices have prerequisites to grow in the first half of 2024 due to rising costs in an overheated economy. At the same time, maintained strict price controls will limit and slow down the process of transferring costs into consumer prices.

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. The X13 procedure in the JDemetra+ app has been applied to make a seasonal adjustment. The dynamics of seasonally adjusted prices and inflation of unregulated services are presented as a range because they can be assessed through various approaches.

The decisions of the National Bank to restore banks' access to standing facilities starting from January 2024 and to increase reserve requirements are a response to increased inflation risks, but these decisions seem insufficient to mitigate the risks

Increasing the reserve requirements for banks' liabilities in foreign currencies by 2 p.p. will allow to withdraw about Br0.6 billion of excess liquidity. At the same time, the banking system — in the absence of heavy shocks — will continue operating in a state of liquidity surplus, as its volume has fluctuated around Br2-3 billion in recent months.

The National Bank announced the restoration of banks' access to standing facilities starting from January 3, 2024, but lowered the rate on overnight deposits from 8.5% to 4% and preserved the rate on overnight loans at 10.5%. Rates on overnight deposits and loans set the boundaries of the interest rate corridor for the National Bank's operations, within which the Interbank Lending Rate (IBL) will fluctuate, if there are no heavy shocks.

The mechanism of the National Bank's return to auction operations to regulate liquidity, which are designed to ensure the dynamics of the Interbank Lending Rate is close to the refinancing rate, has been vaguely formulated. If auction operations are not regular, then, if the liquidity surplus is maintained, the Interbank Lending Rate will come to the lower limit of the interest rate corridor, which implies its increase from the current 1-2% to 4-5%. **In the context of the current inflation above 5% and its expected increase, the 4–5% Interbank Lending Rate does not restrain economic inflation and price growth.**

If inflation accelerates in 2024 as forecasted, an increase in the Interbank Lending Rate from 1–2% to 4–5% (even with a corresponding increase in interest rates on Belarusian ruble deposits and market loans) will only mean preventing the loosening of monetary conditions, which remain loose in Q4-2023. **It may well be that the National Bank will gradually increase the estimated values of standard risk and the overnight deposit rate during 2024 in order to consistently increase the Interbank Lending Rate and to avoid a sharp shock from tightening market lending conditions.** Private businesses and households will mainly experience the direct effects of rising interest rates. The public sector is “hedged” against the risk of changes in market lending conditions by enjoying access to directed financing, which — judging by the unchanged refinancing rate— will continue to be actively practiced in 2024.