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POLICY BRIEF SERIES

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Monetary Policy in Belarus Since Mid-2020: From Rules to Discretion

The most important "safeguard" against negative consequences from government's economic policy mistakes is an independent monetary policy aimed at maintaining inflation near a pre-announced target and smoothing out short-term fluctuations. In Belarus, various monetary policy regimes have been employed and, for most of history, the ability of the National Bank of Belarus to set goals and deploy monetary policy instruments without government intervention has been limited. As a result, monetary policy in Belarus tend to exacerbate negative shocks to the Belarusian economy rather than play a stabilizing role. Since mid-2020, the National Bank has de facto lost operational and institutional independence, and monetary policy has become discretionary – focused on stimulating economic activity. As of 2024 this discretionary and expansionary monetary policy has increasingly come into conflict with the need to ensure macroeconomic stability.

Monetary Policy Design in Belarus: Developments in the Last Decade

Since 2015, the National Bank of Belarus (henceforth the National Bank) has declared their monetary policy regime to be monetary targeting. The primary goal of such policy is price stability, while the intermediate target is broad money supply growth. However, research results show that monetary targeting was employed only until mid-2016. From mid-2016 to mid-2020, the National Bank implicitly employed flexible inflation targeting (Kharitonchik, 2023b).

In mid-2020 the National Bank de facto lost its operational independence as the bank was no longer in control of the rules concerning monetary policy (Kharitonchik, 2023a). In 2022-2024, among other things, targets were set for inflation, the growth of the ruble monetary base, broad money supply, the banks' claims on the economy, and the refinancing rate level. Thus, the National Bank seeks to simultaneously control both the volume of money in the economy and the prices. This is, in practice, expressed in the implementation of discretionary and situational monetary policy.

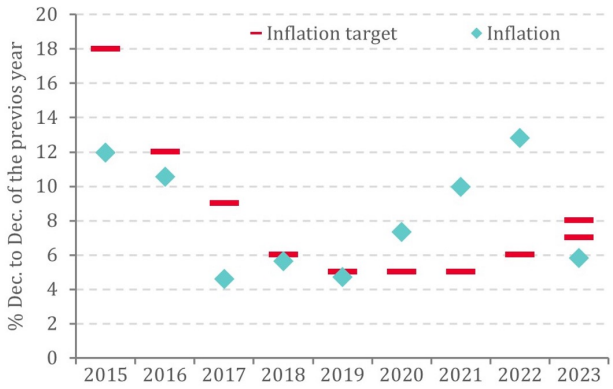
Under pressure from the government, the National Bank's monetary policy has since mid-2020 focused on stimulating economic activity, with a high degree of tolerance to inflationary risks. After the US, EU, UK, and several other countries imposed strict sanctions on Belarus in the beginning of 2022, the government's pressure on the National bank to support economic activity increased even further.

Since October 2022, the only inflation regulator has been strict price controls, exercised by the government in the form of a system of price regulations for approximately 85 percent of the items in the consumer basket. According to the system, manufacturers are obliged to coordinate wholesale prices with government authorities and retailers were in Q4 2022 forced to adjust prices. The system has been modified several times, but as of 2024, it continues to operate in an extremely rigorous version.

Besides the erosion of operational independence, the recent years have been characterized by a marked decline in the institutional framework for executing monetary policy. Aspirations to enhance transparency and accountability of the National Bank to the public seem to be history, at least for the time being. The frequency of the bank's communication has decreased significantly and its content, as well as the bank's published data and analytical materials have deteriorated. There are no longer any National Bank briefings on the outcomes of its board meetings, nor are there clear explanations of the decisions made or meetings with the expert community.

The National Bank also introduces uncertainty and undermines confidence in its policies with its strange approach to setting and announcing inflation targets. The increased inflation target, from the previous 5, to 7-8 percent for 2023 is unexplained, the explicit inflation target for 2024 was not presented until the end of August 2023, and the medium-term inflation target is nonexistent. Under such conditions, investment planning and forecasting becomes challenging, necessitating substantial efforts to rebuild trust in monetary authorities for the future.

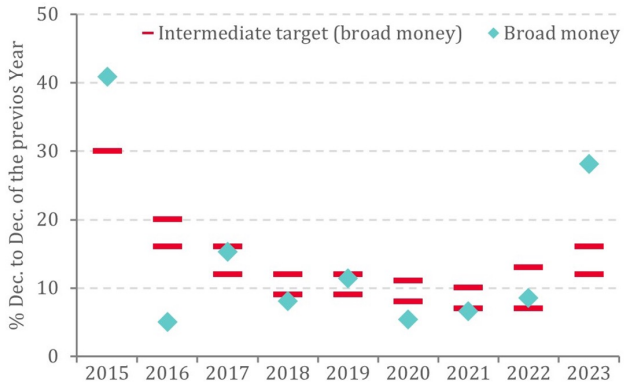
Figure 1. Inflation and inflation targets in Belarus, 2015–2023.



Source: Author's estimates based on data from Belstat and the National Bank of Belarus.

Between 2020 and 2023, the National Bank was unable to effectively implement monetary policy in a coordinated manner, falling short in achieving de jure primary and intermediate targets. Thus, inflation in 2020–2022 was significantly higher than targeted levels, while the money supply growth was close to the lower bound of its target range (see Figure 1 and 2).

Figure 2. Broad money growth and its target in Belarus, 2015–2023.



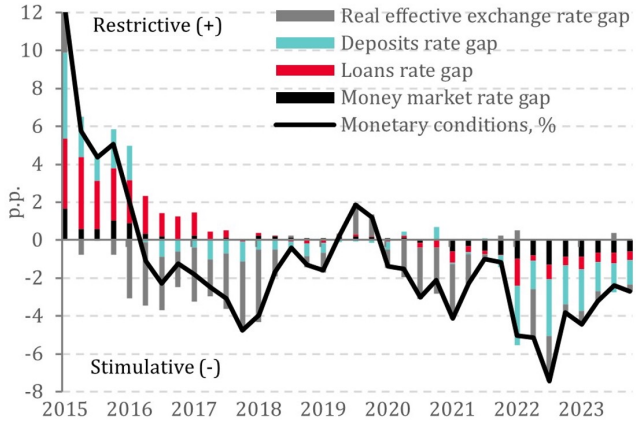
Source: Author's estimates based on data from the National Bank of Belarus.

In 2023, the inflation was below its target due to total price controls, while money supply growth was twice its target (see Figure 2). Such targeted monetary policy dynamics indicate the instability of the economy's demand for money and the money multiplier, the instability and poor predictability of money velocity in the face of shocks to the Belarusian economy, as well as the lack (or inability) of a strict commitment by the National Bank to achieve the primary goal of monetary policy.

Monetary Conditions Between 2020 and 2023

Monetary conditions are calculated as a weighted combination of deviations of real interest rates on assets in Belarusian rubles and the real effective exchange rate of the Belarusian ruble from their equilibrium levels. As detailed in Figure 3, the monetary conditions for 2020–2023 are considered stimulative for economic activity and pro-inflationary.

Figure 3. Monetary conditions in Belarus,2015–2023.



Source: Author's estimates based on QPM BEROC (Kharitonchik, 2023b).
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 (or inflation-neutral) levels (assessed within the model). Positive monetary condition values indicate their restraining-economic-activity and disinflationary stance, and negative monetary condition values indicate their stimulating and pro-inflationary stance.

In 2020, the soft monetary conditions (the combined effect of interest rates and the exchange rate on the economy) were determined by the behavior of the exchange rate. The Belarusian ruble weakened significantly and became undervalued in 2020 due to a sharp increase in demand for foreign currency at the onset of the Covid-19 pandemic in Belarus and following the presidential elections in August 2020.

As a result of the National Bank's discretionary monetary policy, interest rates' volatility significantly increased. A deterioration of the liquidity situation in the banking system and increased risks to the economy during the acute phase of the socio-political crisis in 2020 resulted in interest rates restraining economic activity in September-December 2020.

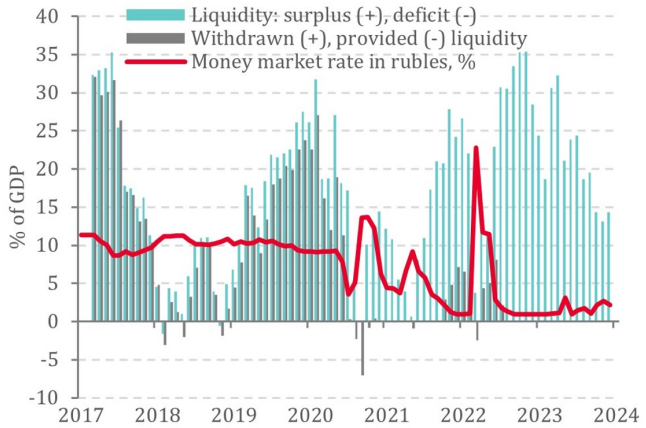
In 2021, there was a notable improvement in the economic situation in Belarus compared to the crisis experienced in 2020. External demand for

Belarusian goods and services rose, and export prices increased significantly which contributed to an increase in foreign currency earnings. As a result, the undervaluation of the Belarusian ruble neutralized during 2021, the banking system moved to a liquidity surplus, and interest rates decreased noticeably, creating soft monetary conditions (see Figure 3).

In 2022–2023, monetary conditions became even softer against the backdrop of increasing priority for the National Bank to support economic activity over inflation containment. The Belarusian ruble again became undervalued which increased foreign trade and allowed for the banking system's liquidity surplus to expand significantly (see Figure 4).

The realization of a substantial liquidity surplus in 2022 resulted from the National Bank's active emission policy, likely associated with considerable government pressure. The National Bank injected at least 1.7 billion Belarusian rubles (0.9 percent of GDP) into the financial system through lending to non-deposit financial organizations in 2022, and more than 1.9 billion Belarusian rubles (1 percent of GDP) in 2022 and 1.1 billion Belarusian rubles (0.5 percent of GDP) in 2023, through the purchase of government bonds on the secondary market.

Figure 4. Banking system liquidity in Belarus, 2017–2023.



Source: Author's estimates based on data from Belstat and the National Bank of Belarus.

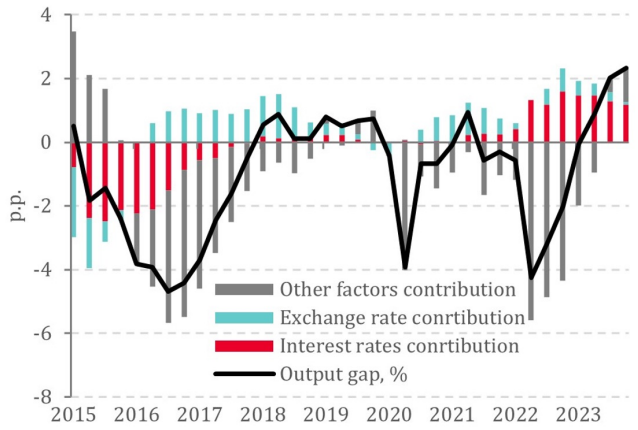
Under a colossal and stable liquidity surplus – not withdrawn by the National Bank – interest rates in the money and credit-deposit markets, in 2022-2023, repeatedly reached historically low levels in nominal terms, and in real terms remained significantly below their equilibrium levels (see Figure 3).

The Monetary Conditions' Impact on Economic Activity and Inflation in Belarus, 2022–2024

Under loose monetary conditions there was a significant strengthening of the credit impulse (share of new loans in GDP) from Q3 2022 and onwards (BEROC, 2023). In this environment of increased credit activity, the money supply grew at a rapid pace in the second half of 2022–2023 (see Figure 2). The money supply growth significantly exceeded an inflation-neutral pace and by the end of 2023, the volume of real money supply exceeded the inflation-neutral level by almost 10 percent.

Expansionary monetary policy was one of the drivers of the rapid economic recovery in the second half of 2022–2023. The negative output gap, which widened in Q2 2022, following increased sanctions against Belarus, was offset in Q1 2023. Moreover, in Q2–Q4 2023, GDP surpassed its equilibrium level (see Figure 5).

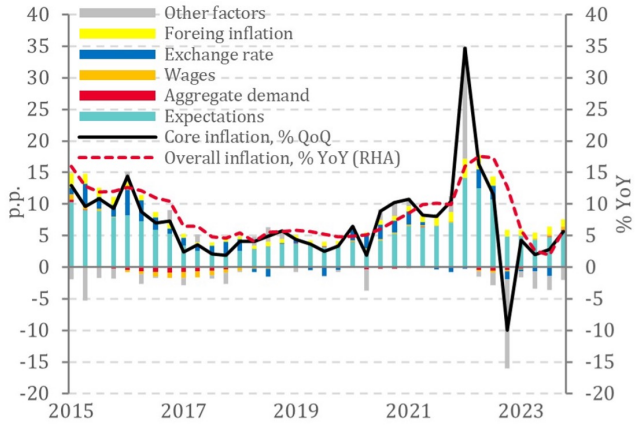
Figure 5. Output gap decomposition in Belarus, 2015–2023.



Source: Author's estimates based on QPM BEROC (Kharitonchik, 2023b).
Note: The output gap is the deviation of real GDP from its potential (or equilibrium) level, where potential is understood as such a volume of GDP that does not exert any additional pro-inflationary or disinflationary pressure.

By 2024, the Belarusian economy reached a state of moderate overheating (see Figure 5). Currently, loose monetary policy fuels demand but the ability to adjust supply to increased demand levels is limited under sanctions and labor shortages. This mismatch between supply and demand would normally lead to a significant acceleration of inflation. However, due to the strict price controls, this is yet to realize. In fact, inflation reached a historically low value of 2.0 percent Year over Year (YoY), in September 2023. Nonetheless, inflation in Belarus began to accelerate in Q4 in 2023 and amounted to 5.8 percent YoY at the end of the year. In an environment of excess demand and a shortage of workers, firms' costs rise and translate into higher selling prices, albeit on a limited scale and with a time lag due to the price controls (see Figure 6).

Figure 6. CPI inflation in Belarus, 2015–2023.



Source: Author's estimates based on data from Belstat. Calculations based on QPM BEROC (Kharitonchik, 2023b).

A prolonged combination of total price controls and loose monetary policy leads to an inflationary overhang – the potential for delayed accelerated price growth. Inflation overhang is a highly undesirable phenomenon since it increases the risk of a price surge in the future and the need for a sharp and aggressive tightening of monetary policy. The inflationary overhang in Belarus is estimated at 5–9 percent (for the end of 2023). This means that there is a risk of a sharp increase in prices by 5-9 percent if price controls are removed or significantly relaxed.

Conclusion

Since mid-2020, the National Bank has de facto lost its operational independence, and monetary policy has become discretionary, focused on stimulating economic activity. By the beginning of 2024, this discretionary and overly loose monetary policy has increasing come into conflict with the task of ensuring macroeconomic stability.

The Belarusian economy enters 2024 in a state of low economic growth potential (about 1 percent per year) and an imbalance of supply and demand, which creates threats of intensified inflation and a decline in foreign trade.

Attempts by the authorities to artificially maintain high rates of GDP growth and low inflation through excessively stimulating economic policies and archaic price controls may lead to an

economic overheating by the end of 2024 similar to the situations leading up to the currency crises in 2009, 2011 and 2015. Under such developments, the fragility of the economy and the likelihood of an economic crisis in Belarus will increase.

To prevent such negative development, it is critical to gradually normalize the monetary policy design in coordination with fiscal policy. Key recommendations from experts for a strengthening of the stabilizing role of monetary policy include ensuring the National Bank's independence, eliminating discretionary and subjective policymaking, and outlining a clear hierarchy of monetary policy goals (Kruk, 2023).

Simulation results indicate that the use of flexible inflation targeting is the most preferable monetary policy strategy for Belarus under existing sanctions and internal and external capital control measures (as discussed in Kharitonchik, 2023a).

Lastly, as monetary policy is about managing expectations for which trust (i.e. credibility) plays a key role, restoring the public's trust in the National Bank is essential. To achieve this, the National Bank needs to reestablish communication with the public and resume the publication of analytical and statistical reports, at a minimum matching the extent seen in early 2021.

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