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INFORMATION DISCLOSURE

This Review includes a detailed description of the current internal and external macroeconomic setting and an agreed set of forecasts that takes into account the interrelationships between the economies of the EDB operating region and the external sector.

The forecasts of the main macroeconomic indicators were prepared by the EDB jointly with the EEC using an integrated system of models based on a multi-country structural dynamic macroeconomic general equilibrium model. More detailed information about the structure of the integrated system of models, its main components, and its use for analysis of the macroeconomic situation and forecasting is contained in a joint EDB and EEC report entitled “Forecasting System for the Eurasian Economic Union”.

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LIST OF ABBREVIATIONS

Belstat – National Statistical Committee of the Republic of Belarus
CPI – Consumer Price Index
EAEU – Eurasian Economic Union
ECB – European Central Bank
EDB – Eurasian Development Bank
EEC – Eurasian Economic Commission
GDP – Gross Domestic Product
IBL – Interbank Loans Market
ISM – Integrated System of Models
IT – Information Technology
NFO – Non-Financial Organization
OPEC – Organization of Petroleum Exporting Countries
pp – percentage point
RB – Republic of Belarus
RB MF – Ministry of Finance of the Republic of Belarus
RB NB – National Bank of the Republic of Belarus
RF – Russian Federation
U.S. or USA – United States of America
% – per cent
% YoY – Year-on-Year Growth Rate
SUMMARY

The economic development of the Republic of Belarus in 2019 progressed against a somewhat difficult external setting. Global economic growth slowed down, largely due to tensions in world trade that undermined investment demand and business confidence. An uncertain global outlook put pressure on commodity prices: most of them trended down last year.

Early this year the Belarusian economy found itself operating in even more challenging external conditions. The spread of coronavirus has disrupted production chains and worsened economic sentiment. The EDB’s base case projections envisage stabilization of the epidemic during the year; nevertheless, it will lead to a global economic slowdown. The unexpected outcome of the negotiations in the OPEC+ Ministerial Committee, which failed to reach consensus to extend the oil production reduction agreement, caused oil prices to fall. We expect the weak price situation in the world energy market to prevail in the coming months. In the medium term, the weakening of the coronavirus epidemic’s negative effects and recovery of demand for hydrocarbons will support oil prices.

The Belarusian GDP growth rate was 1.2% in 2019, down from 3.1% in 2018. The slowdown was mainly due to the completion of the economic recovery phase after the 2015–2016 recession. The changed economic cycle phase mainly manifested itself in consumer demand cooling and a deterioration of net exports of goods and services.

In 2020, Belarusian GDP is expected to decrease by 0.1%. We reduce its projected growth rate by 1.6 pp from our previous estimate, mainly because we expect the oil refining and chemical industries’ output to decrease as supplies of energy commodities to the Republic decrease and global potash fertilizer reserves remain high. External demand weakening, particularly amid the spread of coronavirus, will also be a restraint. Stabilization of the world economic situation and gradual recovery of oil product and potash fertilizer output will lead to cyclical acceleration of GDP growth to 2.0% in 2021.

The Belarusian ruble’s real effective exchange rate continued to strengthen in 2019 as the net supply of foreign exchange expanded in the domestic market. As a result, we estimate the ruble to have been overvalued at the end of the year, which may affect the current account of the balance of payments in the first half of 2020 and cause the national currency to weaken. Decreasing foreign currency revenues from oil product and potash fertilizer exports will be an additional driver of ruble depreciation.

Inflation slowed down to 4.7% in 2019 from 5.6% the year before. The trajectory was influenced by a slowdown of food price growth due to a higher harvest, a weak price situation abroad, an overvalued national currency and a consumer activity slowdown. The EDB projects 2020 inflation to be 5.3%, near
the National Bank’s target. In the medium term, the consumer price index will fluctuate near the National Bank’s targets.

As inflation risks decreased in the second half of 2019, the National Bank reduced its refinancing rate on two occasions by 0.5 pp., to reach 9% p.a. That promoted asset depreciation in the money market. According to our updated estimates, the interest rates had a weak restraining effect on economic activity in 2019, which is largely attributable to the decrease of their neutral levels as monetary policy rates tended to decrease globally. At the beginning of the current year, pro-inflationary risks grew amid increased volatility in the world financial and commodity markets. In this situation, the EDB’s base case projection scenario assumes the IBL rate to stay near 9% in 2020; we expect this to keep inflation near the National Bank’s target. There remains a potential for its reduction in the medium term.

We assess fiscal policy’s contribution to economic growth in 2019 to be weakly positive. The Republic’s budget surplus decreased to 2.4% of GDP, from 3.8% the year before, which is attributable to the decrease in oil revenues as world oil prices and customs duties fell while social spending increased. The consolidated 2020 budget is expected to post a deficit due to higher labor payment expenditures and a limited capacity for increasing revenues. As a result, we expect the tax and budgetary policy’s contribution to GDP growth to remain positive. In subsequent years, we expect a negative fiscal impact due to considerable public debt repayments and moderate revenue trends.
STATE OF THE ECONOMY

Economic Activity

Recovery Growth Peters Out in 2019

The country’s GDP growth rate was 1.2% in 2019, down from 3.1% in 2018. The slowdown was mainly due to the completion of the economic recovery phase after the 2015–2016 recession. The recovery period in 2017 and 2018 was accompanied by a high rate of GDP increase and was largely facilitated by monetary policy easing. Its completion in the second half of 2018 and early 2019 caused economic growth to decrease to its near-potential level, which we estimate at some 1–1.5% (Box 1).

The changed economic cycle phase mainly manifested itself in consumer demand cooling and a deterioration of net exports of goods and services.

GDP Near Equilibrium

Output was uneven in 2019. The first semester saw a considerable slowdown of economic growth (to 0.9% YoY), largely due to the ingress of poor quality oil into the Druzhba oil pipeline. In the second half of the year, economic activity was revived (with 1.5% YoY GDP growth, according to our calculations) as the transit of Russian oil partially recovered, Belarusian oil product exports grew and the harvest of staple grain crops and volume of construction works increased. According to our estimates, that resulted in a near-zero output gap at the end of 2019.

Figure 1. Economic Activity

Source: Belstat, calculations by the authors, EEC
According to our calculations, in 2019 most of the economy’s major sectors reduced their contribution to GDP growth, including industry (to 0.26 pp from 1.35 pp the year before), wholesale and retail trade (to 0 pp from 0.7 pp), and transport activities (to minus 0.1 pp from 0.25 pp). In addition to recovery growth petering out, the said sectors’ trends were also constrained by decreasing exports of oil products and transit of energy commodities, lower production and export of potash fertilizers due to repair works at Belaruskali, as well as weak external demand and the overvalued national currency.

The IT sector was a key driver of economic activity in 2019 (contributing 0.5 pp to GDP growth), which showed high and steady gains. Growth was also supported by the agricultural sector, which increased output considerably after the low harvest of 2018. We estimate its contribution to GDP growth at 0.23 pp after a negative figure (0.28 pp) the year before.

According to an estimate that we obtained using the Integrated System of Models (ISM) implemented at the EDB, economic growth in the Republic of Belarus in 2019 was almost entirely driven by potential output (1.4 pp), while the influence of the cyclical component was minimal (minus 0.2 pp). In 2018, the situation had been the opposite, with the cycle contributing 2.1 pp and the potential, 1.0 pp. The results confirm that the Belarusian economy’s recovery period after the 2015–2016 recession has finished.

Near-equilibrium economic activity, in conjunction with the inflation target attained, points to domestic macroeconomic stability in Belarus that is the basis for steady growth and the Republic’s investment attractiveness.

The maintenance of macroeconomic stability is necessary to strengthen confidence in the Belarusian ruble and the State’s economic policy in general, which enables the National Bank to make the monetary policy transmission mechanism more efficient and reduce shock-induced volatility of the main macroeconomic variables.

With output near its potential level, steady acceleration of economic growth may be brought about by structural measures intended in particular to raise the efficiency of public enterprises and attract foreign investment. The implementation of the action plan for 2020, designed to facilitate economic development and approved in late 2019, may promote the strengthening of Belarus’ economic potential.

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1 For more information see the Joint Report by the EDB and EEC entitled Forecasting System for the Eurasian Economic Union.

Consumer activity slowed down in 2019, as indicated by a decrease in the year’s annual growth in both retail trade turnover (to 4.2%, from 8.3% the year before) and public catering (to 6.4% from 12.6%), attributable to a lending reduction and slowdown in household income growth. At the end of the year, Belstat reassessed downward households’ end consumption expenditures in 2018 and the first half of 2019, which also testifies to more moderate activity in the above period.

Investment activity stayed at the preceding year’s level in 2019. Capital investment grew by 5.7% (vs. 6.0% the year before). The key growth driver was an 11.8% increase of expenditures on the purchase of machinery, equipment and vehicles. The import intensity of investment in fixed assets in use decreased to 59.9% during the year (vs. 64.3% the year before) but remained high, which restricts capital investment’s contribution to economic growth and keeps the economy vulnerable to external shocks. The highest rates of investment activity growth in 2019 were observed in the Lyuban and Cherikov districts, where major projects are being implemented in the chemical and energy industries, respectively.
Industrial Growth Slows Down

Industrial growth slowed down considerably in 2019. Output increased by 1% during the year after 5.7% in 2018. The industrial sector’s performance was constrained by a slowdown of economic activity in the main trade partner countries, the overvalued national currency, and a gradual weakening of domestic consumer demand. A decrease in oil product output due to temporary oil transportation difficulties in the 2nd quarter and a decrease in potash fertilizer production due to repair works at Belaruskali OJSC in the second half of the year were additional adverse factors.

Businesses’ Economic Sentiment Worsens

The considerable increase in manufacturing output at the end of 2019 (to 6.8% YoY in December after 1.8% the month before) is probably temporary, according to our estimates. This is indicated in particular by a decrease in the industry’s economic sentiment index calculated by the National Bank in December 2019 (to 0.2%,3 down from 5.4% in December 2018). Our calculations4 show a decrease in demand and orders for the industrial sector’s products in both domestic and foreign markets at the end of the year.

Industrial enterprises’ inventory stocks increased considerably as of 1 January 2020 (to 66.3% of average monthly output, from 60.9% a year before), which may worsen their financial performance in the future.

Agricultural Output Recovers

Agricultural output increased by 2.9% YoY in 2019 after decreasing by 3.3% the year before. The sector’s growth began recovering in the second half of the year and is attributable to a higher gross yield of staple crops, which was mainly caused by the climate.5

Figure 4. Production Activity (period’s growth rate year-on-year)

Source: Belstat

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3 Seasonally smoothed values of the industry’s economic sentiment index are cited.
4 Some indicators in the balances mentioned in enterprises’ answers to the questions about the economic situation in the National Bank’s questionnaire have been seasonally smoothed.
5 The unfavorable weather conditions of 2018 had reduced the yield of staple crops considerably to form a low comparison base in the second half of 2018.
Households’ real disposable incomes grew by 6.0% in 2019 (vs. 7.9% in 2018). The indicator’s change was shaped by a slowdown of real wages growth to 7.3% (vs. 12.6% in the preceding year) as economic growth decreased. We expect real wages to continue to outrun their equilibrium growth rate, which puts pressure on consumer prices.

Excess salary growth was observed in State budget funded organizations in 2019 (up 8% from the 2018 level in real terms), to 80.2% of the Republic’s average figure by December. Its rise was driven by a 12.6% increase in the Grade I salary from September 2019.

According to our estimates, foreign trade operations made an even larger negative contribution to economic growth in 2019, as indicated by export and import volumes of physical goods. Physical exports of Belarusian products decreased by 2.0% during the year (after 5.3% growth in 2018). The export indicators were harmed by the strengthening of the Belarusian ruble’s real effective exchange rate, slowdown of external demand, and reduced supplies of potash fertilizer and oil products. Physical goods imports increased by 3.5% in 2019 after 5.0% growth the year before, which is primarily attributable to fewer imports of energy products and non-food consumer goods into Belarus as demand slowed down. Notably, imports accelerated in the second half of the year, possibly due to the recovering oil supply, increasing import-intensive capital investment and strengthening the real effective exchange rate of the Belarusian ruble.
Unemployment decreased to 4% as of the end of 2019, from 4.8% a year before. Workforce shrinkage, observed since 2011 amid the adverse demographic trends towards the population’s ageing and worsening of its age structure, continued (by 1.2% YoY in the 4th quarter). The trend of terminations exceeding the number of hires continued.

**Figure 6. Labor Market Indicators (period’s growth rate year-on-year)**

![Graph showing labor market indicators](image)

Source: Belstat

**Inflation**

**Inflation Within Target Range**

The rate of growth of the consumer price index was 4.7% YoY in December 2019, down from 5.6% YoY in December 2018. Its performance was mainly attributable to a slowdown of core inflation (to 3.5% YoY, from 4.8% YoY the year before), which reflects changes in the prices of goods not subject to direct administrative influence. Core CPI’s trajectory was shaped by food price deceleration, weak external inflation, strengthening of the Belarusian ruble’s real effective exchange rate, and the consumer activity slowdown.

**Figure 7. Inflation (the last month in a quarter vs. the last month of the same quarter a year before)**

![Graph showing inflation](image)

Source: Belstat, RB NB, calculations by the authors
According to the National Bank, the level of inflation expected by the population in the following twelve months was 11.9% in November 2019, 0.7 pp lower than in November 2018. The deceleration of food price growth may have had a positive effect on inflationary expectations. Nevertheless, the figure is still above the inflation target.

Food price growth decelerated considerably by December 2019, to 4.3% YoY (vs. 5.7% YoY in December 2018). The food inflation slowdown was mainly attributable to a greater supply of agricultural produce in the domestic market due to a larger harvest. Thus, according to our calculations, meat and meat product prices that had increased by 11.6% in 2018 mainly due to feed appreciation only grew by 1.3% in 2019. As a result, this goods category contributed an estimated 0.1 pp to the year’s consumer price growth after 1.3 pp in the preceding year. The larger harvest’s effect probably continued in 1Q2020.

Higher Harvest Slows Down Food Prices

Non-food goods appreciated by 3.7% YoY in December 2019 (vs. 3.8% YoY in December 2018). On the one hand, prices were pressurized upwards by fuel appreciation and real wages growing at a higher than equilibrium rate. On the other hand, a weak price situation in the main trade partner countries (mainly in Russia), the overvalued real effective exchange rate of the Belarusian ruble and the gradual consumer activity slowdown restricted the materialization of pro-inflationary factors.

Service prices grew by 6.9% in 2019 after 8.1% the year before. The slowdown mainly results from less price appreciation in domestic, communication and educational services. Despite the slowdown, inflation in this sector is still outrunning that of other segments of the consumer basket.

Moderate Non-Food Price Growth

Inflationary Expectations Decline

Figure 8. Inflation Components (the last month in a quarter vs. the last month of the same quarter a year before)
The External Sector

Foreign Trade Balance Deteriorates

The balance of foreign trade in goods and services posted a deficit of USD 0.2 billion (0.4% of GDP) in 2019 after a surplus of USD 0.9 billion (1.6% of GDP) the year before. The indicator’s negative trend resulted from a considerable deterioration of the balance of trade in goods that was not fully offset by the improvement of the services trade balance.

![Foreign trade (four quarters’ moving total)](image_url)

Source: Belstat, RB NB, calculations by the authors

Deficit of Foreign Trade in Goods Grows

The trade deficit was USD 4.1 billion (6.4% of GDP) in 2019, nearly USD 1.6 billion higher than in 2018. According to our calculations, it mainly changed on account of imports of non-mineral goods to Belarus in monetary terms (more than USD 2 billion, according to Belstat) outrunning the growth of their exports (some USD 0.7 billion). The balance of trade in machinery, equipment and vehicles, as well as in other goods, deteriorated considerably, which may be attributable to, inter alia, the strengthening of the Belarusian ruble’s real effective exchange rate and external demand weakening, as well as growing domestic investment in fixed assets in use, which remains highly import-intensive. In the second half of the year, a decline in potash fertilizer sales abroad had an additional adverse effect on the foreign trade balance.

External trade in mineral products, both their imports and exports, decreased considerably in 2019 (by 11.4% and 18.9%, respectively, compared with 2018). As a result, that commodity group’s negative balance increased by USD 0.35 billion over the year. Foreign trade in commodities was affected by the reduction of duty-free exports of Russian oil products to Belarus, the implementation of the tax maneuver in the Russian petroleum industry, and the decreased world commodity prices.
Mutual trade within the EAEU became more significant for the Republic of Belarus in 2019. The share of Belarusian goods exports to countries of the Union was 44.2% over the year, 3.1 pp higher than in the previous year. Such a trend is due to a decrease in sales to other countries, mainly on account of the fall in mineral product exports.

Foreign trade in services continues to provide the country with foreign exchange revenues. In 2019 its surplus reached USD 3.8 billion (up from USD 3.4 billion the year before). Its continued positive trend was mainly supported by growing exports of computer services amid vigorous development of the national IT sector.

Despite the foreign trade deterioration, the positive balance of payments for goods and services imports and exports increased to USD 2.5 billion in 2019, from USD 2.3 billion the year before. Such a trend mainly results from decreasing payments for goods sold to the Republic, which was probably the reason for the increased indebtedness of Belarusian organizations to foreign counterparties (up 7.5% YoY as of 1 January 2020), including overdue debt (up 24.8% YoY).
Gold and Foreign Exchange Reserves Increase

The international reserve assets of the Republic of Belarus amounted to USD 9.4 billion as of 1 January 2020, USD 2.2 billion more than the year before. The growth of the gold and foreign exchange reserves was driven by the National Bank’s increased purchases of foreign currency in the market as net supply in the domestic foreign exchange market expanded. We estimate the country’s international reserves to cover 2.7 months’ worth of imports of goods and services as of 1 January 2020 (vs. 2.1 months’ a year before).

Figure 12. Belarus’ International Reserve Assets

![Bar chart showing the growth of international reserve assets and months of imports from 2017 to 2019](chart.png)

Source: RB NB, calculations by the authors

The Fiscal Sector

Budget Surplus Decreases

In 2019, the Republic’s budget surplus was 2.4% of GDP (3.2 billion rubles), down from 3.8% of GDP (4.7 billion rubles) the year before. Its contraction is mainly attributable to decreasing income (by 1.5% of GDP), including revenue from foreign trade (by 0.9% of GDP). This item’s negative performance was caused by decreasing export sales of Belarusian oil products, a worsening price situation in the world market for hydrocarbons, and the tax maneuver implemented in Russia. According to our calculations, the last factor also led to a decrease in free income from foreign States (customs duties for the transit of 6 million metric tons of oil under arrangements with Russia).

The expenditure structure featured a faster growth rate of social spending, which may be attributable, inter alia, to the salary increase in the State budget sector. We generally estimate the fiscal policy’s contribution to GDP growth in 2019 to be weakly positive (some 0.1–0.2 pp).

Debt Burden Decreases

The public debt of the Republic of Belarus was 44.8 billion rubles (33.7% of GDP) as of 1 January 2020, after decreasing by 0.6 billion rubles (1.7% of GDP) over the year. We estimate the ruble equivalent of public debt to have...
In the second half of 2019, Standard & Poor’s and Fitch confirmed Belarus’ B sovereign credit ratings with a stable outlook. On the one hand, this was brought about by the maintenance of macroeconomic stability and by the Republic’s strict adherence to its debt obligations. On the other hand, constrained prospects of economic growth in conjunction with a high share of public debt denominated in foreign currency and large forthcoming payments on public liabilities (some USD 3.6 billion annually in 2020–2023) remain risk factors.

**Credit Ratings Confirmed**

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Monetary Conditions

Refinancing Rate Declined to Historic Minimum

As inflation risks declined in the second half of 2019, the National Bank reduced its refinancing rate by 0.5 pp on two occasions to reach 9% p.a. The IBL rate, a monetary policy benchmark, decreased in response to the regulator’s decisions. Nevertheless, it continued to move within the upper half of the interest rate band, which may be attributable to high and persistent inflationary expectations.

Interest Rates Near Neutral Levels

Nominal interest rates of the loan and deposit markets decreased in the second half of 2019, following the refinancing rate. As a result, after temporarily tightening early in the year, conditions for bank lending in the national currency eased in the second semester.6

According to our updated estimates, interest rates generally exerted a weak constraining effect on economic activity in 2019, which is largely explained by the decrease in their neutral levels amid a global trend towards lower policy rates (Box 2). As a result, there remains potential for further easing of monetary policy barring significant inflationary shocks.

Figure 15. Interest Rates (period’s average)

Source: RB NB, calculations by the authors

Box 2. Estimate of the Real Equilibrium IBL Rate

The real equilibrium interest rate is an integral component of the macroeconomic models used to analyze, forecast and design monetary regulation measures. In central banks’ practice it is generally used as an indicator of their monetary policy’s tightness: if the actual rate is above the equilibrium one, it is indicative of a contractionary policy – or of a stimulative one in the opposite case.

The equilibrium rate concept may vary depending on the purpose of its use and the time horizon. We consider the indicator that is most relevant to central banks, that is the real interest rate at which inflation and inflationary expectations are consistently at the target level, with output and the exchange rate at their mid-term equilibrium levels.

The equilibrium interest rate is an unobservable variable. Besides, its level may vary with time and depends on a broad range of structural factors not directly affected by monetary policy. This makes it difficult to calculate the indicator and leads to considerable confidence intervals of the estimates.

The EDB uses its Integrated System of Models (ISM) as the main tool for estimating the equilibrium interest rate in the Bank’s member countries. It envisages the attainment of uncovered interest rate parity in the medium term, with the equilibrium rate in a small open economy determined by the equilibrium rate abroad, the expected change of the real equilibrium exchange rate, and the equilibrium risk premium.

According to the results obtained using the ISM, the real equilibrium IBL interest rate in the Republic of Belarus was 4.1% in 4Q2019. Over the past year its level had decreased as the premium for the risk of investing in Belarusian assets declined gradually and amid the global downward trend in interest rates.

To obtain an alternative estimate, we developed a small semi-structural macroeconomic model (SSM) that is based on the same principles as the ISM. Its key difference is the method for working out the equilibrium interest rate. In the model built, we link its level (instead of uncovered interest rate parity in the ISM) to potential GDP growth adjusted for the change of the Belarusian ruble’s equilibrium real effective exchange rate (REER). Potential GDP growth approximates the return on capital, while REER is used in order to account for the exchange rate’s influence on the profitability of investments made in foreign currency, which is relevant to small open economies. So, in establishing the equilibrium rate, our model is close to that described by Hlédic and Vlček (2018)7.

According to the results obtained using the SSM, the equilibrium real IBL rate in Belarus was 3.0% in 4Q2019. Like in the case of the ISM-based calculation, the figure decreased in recent years due to a slowdown of the equilibrium devaluation of the national currency as economic growth gradually recovered after the recession of 2015–2016.

Hence our estimate of the real equilibrium IBL exchange rate in the Republic of Belarus is within the 3–4% range. In conjunction with the 5% inflation target, this means a neutral IBL rate at some 8–9% level.
Credit Activity Growth Slows Down

The growth of bank lending to non-financial organizations and individuals slowed down in 2019, to 10% YoY as of 1 January 2020 (vs. 12.7% in 2018). That mainly results from the revaluation of foreign exchange assets due to the Belarusian ruble’s strengthening versus the U.S. dollar. The growth of lending to individuals also decelerated in the reporting period (to 22%, from 28.4% the year before). Activity slowdown was observed in both its consumer and housing segments. Retail borrowing was affected by the exhaustion of deferred demand and by the prudential measures taken by the National Bank. Real estate lending declined as a result of temporary restrictions imposed by major Belarusian banks early in the year.

An increase of enterprises’ borrowing was observed in the reporting period, driven entirely by growth of foreign currency borrowing (up 7.6% in 2019 after a 2.6% decrease the year before). The growth of ruble loans to organizations slowed down to 6.4% in 2019, from 9.6% in the preceding year. The change of businesses’ conduct may be attributable, in particular, to greater easing of the conditions for bank lending to big business in foreign currency compared with ruble loans recorded by the Central Bank.8

Share of Foreign Exchange in Loans and Deposits Continues to Decrease

The share of foreign currency bank deposits decreased by 4.3 pp during the year to reach 60.6% as of 1 January 2020, which was driven by national currency deposits remaining higher-yielding than those denominated in foreign currency, as well as by the continued macroeconomic stability.

The share of foreign currencies in bank loans to legal entities decreased by 0.3 pp during the year, to 63.8% as of 1 January 2020. The trend towards

Figure 16. Factors’ Contribution to the Growth of Banks’ Credit Portfolio (end of quarter vs. end of the same quarter the year before)

Source: RB NB, calculations by the authors

a declining foreign currency share in this segment of the financial market abated in the second half of 2019, largely on account of growing foreign currency lending to businesses.

While decreasing, the share of foreign currency in Belarusian banks’ assets and liabilities remains one of the highest in the region, which limits the effectiveness of the monetary policy being pursued. The implementation of the Strategy for Raising Confidence in the National Currency till 20359 will be important in this respect.

According to the RB NB, net supply of foreign currency in the domestic market was USD 2.3 billion in 2019, more than twice as much as in the preceding year. Such a movement is almost entirely explained by changed conduct of resident enterprises, which sale net foreign currency equivalent to USD 0.5 billion, compared with a net purchase of USD 0.7 billion the year before. We consider the key factors behind that to include the greater surplus of payments for exports and imports of goods and services and the expansion of foreign currency lending to legal entities.

Individuals almost halved their net supply of foreign currency in 2019, to USD 0.6 billion, as they increased purchases considerably (by USD 1.2 billion). The indicator was affected by the exhaustion of deferred consumer demand and by individuals’ gradual switch to a savings behavior pattern.

The Belarusian ruble’s exchange rate versus the major currencies showed a mixed trend in 2019. It strengthened versus the U.S. dollar and Euro (by 2.4% and 5.3% YoY in the 4th quarter, respectively) as net supply expanded in the

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domestic market. Conversely, it weakened in relation to the Russian ruble (by 1.9% YoY in 4Q) as the Russian currency strengthened globally.

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<th>Real Effective BYN Exchange Rate</th>
<th>Overvalued</th>
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The real effective Belarusian ruble exchange rate continued to strengthen last year, which is attributable to the expanding net supply of foreign currency in the domestic market and to inflation in Belarus staying higher than in her main trade partner countries. We estimate it to have kept the real effective exchange rate in overvalued territory at the end of the year. That reduced the external sector’s inflationary pressure but made Belarusian producers less price-competitive.
ECONOMIC OUTLOOK

Background

Economic growth in Belarus’ main trade partner countries decelerated in 2019. Russia’s GDP increased by 1.3% that year, after 2.5% the year before. Economic growth in the first half of the year was constrained by the increased fiscal load and weak external demand. In the second semester, Russian output began showing signs of recovery, supported by the easing of tax and budgetary policy and bank lending conditions.

The Eurozone’s aggregate GDP growth declined to 1.2%, from 1.9% in 2018; the U.S. economy grew by 2.3% after 2.9%, and China’s grew by 6.1% after 6.6%. The slowing global trade and worsening economic sentiment amid mounting trade protectionism constrained production and investment activities and were only partially offset by stimulative domestic policies.

Moderate External Demand in Medium Term

The external setting remained highly uncertain early this year. On the one hand, the Phase 1 trade agreement entered into by the USA and China reduced the risk of global recession. On the other hand, the spread of the coronavirus may offset the positive effect of emerging progress in the settlement of their trade conflict. The EDB’s base case projection is for the epidemic to gradually stabilize this year but that it will still depress economic activity worldwide.

Russian GDP is projected to grow by 1.3% in 2020, like the year before. Domestic demand will be supported by the implementation of the national projects passing into their main stage and by household income stimulation measures. Russian non-energy producers may derive additional competitive advantages from a weakening ruble. On the other hand, the said factors’ positive contribution to economic growth may be offset by the adverse consequences of the spread of coronavirus and falling oil prices, resulting

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In December 2019 Boeing Corporation announced the suspension of production of its 737 MAX airliners. According to the company’s latest statements, it expects to resume production in mid-2020. For more information see Boeing Statement Regarding 737 MAX Production and Boeing Statement on 737 MAX Return to Service.

Lower Oil Prices in 2020

The uncertain global outlook put pressure on commodity prices in 2019, with most of them depreciating. The fall of energy prices accelerated early this year because of the negative effect of the spread of coronavirus on energy consumption predicted by international organizations, as well due to the unexpected outcome of negotiations in the OPEC+ Ministerial Committee, which failed to reach consensus to extend the oil production reduction agreement. We expect a weak price situation in the world energy market to prevail in the coming months. In the medium term, the weakening of the coronavirus epidemic’s negative effects and recovery of demand for hydrocarbons will support oil prices.

11 In December 2019 Boeing Corporation announced the suspension of production of its 737 MAX airliners. According to the company’s latest statements, it expects to resume production in mid-2020. For more information see Boeing Statement Regarding 737 MAX Production and Boeing Statement on 737 MAX Return to Service.
Inflation in Russia slowed down to 3.0% YoY in 2019, which is below the Central Bank's target of 4%. This was facilitated by a strengthening ruble, moderate consumer activity and increasing supply of food. The EDB projects the said factors’ impact to gradually weaken in the current year as household demand strengthens and the Russian currency's exchange rate decreases. The resultant 2020 inflation is estimated at 3.8%, while in 2021–2022 inflation is projected to be close to the target set by the Bank of Russia.

Consumer price index growth in the Eurozone and USA is projected to be lower than the ECB and FRS targets throughout the time horizon, amid moderate economic activity, decreasing energy prices and low inflationary expectations. Inflation in China is expected to slow down gradually after accelerating in 2019 as the meat price shock effect peters out.

Notable among the projection’s key assumptions is a 10% decrease of oil product and potash fertilizer output from the previous year’s level, which is included in the base scenario. In the former case, the output reduction results from the fall in oil supplies in the 1st quarter of the current year. These are expected to eventually recover to their average quarterly level of 2019. The fall in potash fertilizer output is attributable to their high global reserves and a projected slowdown of China’s economic growth in 2020. According to our calculations, these two factors will remove 0.6–0.8 pp from GDP growth. For 2021–2022, the projection assumes oil imports to recover to 18 million metric tons per year and potash fertilizer output to increase as external demand strengthens gradually and domestic production capacity expands.

The projection of the situation in the fiscal sector is mainly based on the Guidelines of the Budgetary, Financial and Tax Policy of the Republic of Belarus for 2020–2022. The current year’s consolidated budget is expected to post a deficit, mainly on account of the decrease in customs duties levied on oil products and increased labor payment expenses. As a result, we project the tax and budgetary policy’s contribution to be positive. In subsequent years, the fiscal impulse is expected to be negative because of limited room for stimulation, due to considerable payments on public debt and moderate income growth.

The projection’s base scenario assumes the positive wages gap to gradually close and wages growth to stabilize at near-equilibrium rates in the medium term. The indicator’s pro-inflationary influence will thus weaken gradually, and from 2021 the contribution of labor remuneration to the consumer price index is projected to be neutral.
Monetary policy will remain focused on attaining the inflation target. The base scenario assumes an inflation target of 5% in 2020, 4.5% in 2021 and 4.0% in 2022.

Table 1. Forecast Key Foreign Economic Indicators

<table>
<thead>
<tr>
<th>Year</th>
<th>Average annual Urals oil price (USD per barrel)</th>
<th>Russia's real GDP growth rate, %</th>
<th>Euro Zone real GDP growth rate, %</th>
<th>Inflation in Russia, % (at end of year)</th>
<th>Inflation in the Euro Zone, % (at end of year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>44.1</td>
<td>1.3</td>
<td>0.7</td>
<td>3.8</td>
<td>0.5</td>
</tr>
<tr>
<td>2021</td>
<td>49.8</td>
<td>1.9</td>
<td>1.3</td>
<td>3.9</td>
<td>1.1</td>
</tr>
<tr>
<td>2022</td>
<td>52.8</td>
<td>1.9</td>
<td>1.4</td>
<td>4.0</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Source: calculations by the authors, EEC

Economic Activity

In January this year, the Belarusian economy shrank by 1.9% YoY. The key factors behind the fall in output included the output decrease in the oil refining, chemical and energy industries (by 41.2%, 25.2% and 10.5% YoY, respectively) due to the oil import decrease, absence of a contract for potash fertilizer exports to China, and abnormally warm weather. Those factors’ impact is expected to persist in February and March, which will keep GDP growth negative in 1Q2020 and produce a negative output gap.

Economic Growth to Slow Down in 2020

In accordance with the base scenario’s assumptions, oil product and potash fertilizer output is projected to partially recover in Q2–Q4, which will cause economic activity to gradually rise and stabilize near equilibrium by the end of the year. We expect consumer demand to keep near its inflation-neutral level. It will be supported by continued socially focused budgetary policy, while a projected slowdown of retail lending, particularly due to altered terms of the instalment plans, will constrain it.

The implementation of a number of major projects, including those aiming to expand the productive capacity of the chemical industry and modernize transport infrastructure, will continue to exert a positive effect on investment activity. On the other hand, the consequences of the worldwide spread of coronavirus may disrupt production chains and worsen economic sentiment, and will restrict the expansion of investment demand in Belarus this year.

**Figure 18.**

**Real GDP**

*period’s growth rate year-on-year*

We expect the above factors to depress Belarusian GDP by 0.1% this year. We have reduced our previous forecast, by 1.6 pp to reflect the negative effect from the temporary output decline in the oil refining and chemical industries and slower than expected growth in external demand and domestic investment activity.

**Risks of Weakened Short-Term Economic Activity**

Risks of an even greater drop in economic activity prevail in the short run in our view. Oil product output may decline even more if crude oil imports continue to decrease. The current coronavirus situation’s consequences for the global economy are still highly uncertain. We expect its adverse effects to be concentrated on the demand side and to have no considerable impact on production capacity. Otherwise we should expect a greater weakening of both external and domestic demand. There also remains the possibility of oil prices staying low for a long time and exerting a stronger impact on economic agents’ expectations and investment demand than assumed in the base case scenario.

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13 Here and elsewhere the chart ranges correspond to the 10%, 50% and 75% confidence intervals.

GDP growth is projected to accelerate to 2.0% in 2021, mainly on account of a cyclical recovery of economic activity. The key driver will be output expansion in the chemical and oil refining industries after this year’s decline, that will entail growth of goods exports. Gradual stabilization of the global economy and commodity markets will manifest itself in strengthening external and domestic demand, which will promote cyclical growth.

In 2022, the EDB projects Belarusian GDP growth to decelerate to 1.4%. Fiscal policy is expected to exert a contractionary effect on business activity, particularly due to the considerable public debt servicing expenses with revenues from customs duties on oil and oil product exports projected to decrease. Monetary conditions are expected to be near-neutral in the medium term.

The mid-term risks for Belarusian GDP emanate both from the external sector and from the national economy. There remains a probability of considerable global slowdown that will affect business activity in the Republic, primarily via the foreign trade channel due to the high openness of its economy. The implementation of the tax maneuver in Russia is also a source of uncertainty for Belarus. Under an adverse scenario, the country’s investment activity expansion potential may be limited due to increased risks for the country’s economic development. As a result, GDP growth may slow down to 0.5–1% in the long run.

Non-financial organizations’ precarious financial situation, high credit burden and lack of own working capital, noted by the National Bank of the Republic

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Figure 19. Output Gap

Source: calculations by the authors, EEC

15 The tax maneuver in Russia leads to a higher oil import price for the Republic while lowering the customs duties levied on the oil products that the country exports.
of Belarus,\textsuperscript{16} are significant sources of risk for the Belarusian economy. Their operating conditions may worsen, which may weaken their payment discipline and produce more distressed assets.

\section*{Inflation}

\subsection*{2020 Inflation Near Target}

This year, inflation is projected to be close to the National Bank’s target. The influence of the disinflation factors primarily resulting from the weak price situation abroad has continued in early 2020. We expect this influence to gradually weaken during the year, as the Belarusian ruble depreciates and consumer price growth accelerates in Russia. Wages’ continued pro-inflationary pressure will be offset by a temporary decrease in economic activity. As a result, the EDB projects the current year’s inflation to be 5.3%.

The short-term inflation risks are counterbalanced. On the one hand, the external price situation remains weak, and domestic consumer activity may additionally be constrained by the altered instalment plans. On the other hand, there is a chance of accelerated fuel price growth in the domestic market and accelerated weakening of the national currency as the terms of trade in energy commodities deteriorate.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{inflation_graph.png}
\caption{Inflation (for each period, year-on-year)}
\end{figure}

\textbf{Figure 20. Inflation (for each period, year-on-year)}

\textbf{Note:} seasonally adjusted data.

\textbf{Source:} calculations by the authors, EEC

\textsuperscript{16} For more information see the report \textit{Ensuring Financial Stability in 2019 and the Objectives for 2020} delivered by Dmitry Kalechits, Deputy Chairman of the Board of the National Bank of the Republic of Belarus, at an extended Board meeting.
2021–2022 Inflation Also to be Near Targets

In 2021–2022, inflation is projected to fluctuate near the Central Bank’s targets. The influence of economic activity and wages is expected to be close to neutral. The exchange rate will follow an equilibrium trajectory and put no additional upward or downward pressure on inflation.

Pro-Inflationary Risks Persist

The mid-term risks remain on the pro-inflationary side. The population’s expectations, sensitive to price fluctuations of certain goods, remain unanchored. There is a risk of wages increasing at a faster rate than assumed in the projection’s base scenario. There remains some probability of a pro-inflationary effect from the changed terms of trade in energy commodities.

Monetary Conditions

In February this year, the National Bank of the Republic of Belarus lowered its refinancing rate by 0.25 pp, to 8.75% p.a. The decision was explained by an inflation slowdown in late 2019 and early 2020 that was sharper than the regulator had expected. In our opinion, there remains a potential for further rate reductions barring significant inflationary shocks. At the same time, pro-inflationary risks grew in March amid mounting volatility in the world financial and commodity markets. In this situation, the EDB projection’s base scenario assumes the refinancing rate to stay at 8.75% till the end of the current year, which will help keep 2020 inflation near the National Bank’s target.

The IBL rate is expected to fluctuate in the upper part of the National Bank’s interest rate band this year, around 9%. According to our estimates, this IBL rate trajectory means it will stay near the upper boundary of the neutral range that we estimate at 8–9% with the current inflation target in place.

Potential Interest Rate Reduction

There is potential for a nominal IBL rate reduction to 7.5–8.0% in the medium term, which will be facilitated by a gradual decrease in inflation and inflationary expectations. Compared with our previous forecast, we have revised the long-term sustainable IBL interest rate level downward. According to our updated estimates, the global downward trend in neutral interest rates, driven by a deceleration of potential economic growth, is exerting a greater effect on the Belarusian economy than previously thought.

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In 2020, the average annual exchange rate of the Belarusian ruble vs. the U.S. dollar is projected to be around 2.27 BYN per USD (vs 2.09 BYN per USD in 2019). In 2019, enterprises’ net supply of foreign currency grew while the balance of foreign trade in goods and services deteriorated, and may have come at the cost of a considerable buildup of forex payables. We estimate this factor’s influence on the situation in the domestic foreign exchange market to be temporary, so we expect no increase in net supply of foreign currency this year. Decreasing exports of potash fertilizers and oil products may be an additional factor behind the lower supply of foreign currency.

The national currency will weaken in the medium term as well, for Belarusian manufacturers must remain competitive while inflation in their home country stays higher than in its main trade partner countries.

**Figure 21.**

*IBL rate (the period’s average)*

![IBL rate graph](image)

*Source: calculations by the authors, EEC*

**Belarusian Ruble Weakening**

The exchange rate risks emanate both from the external sector and from the national economy. The considerable slowdown in global economic growth is highly likely to reduce revenues from Belarusian exports and, consequently, the supply of foreign exchange within the country. Notable
among the domestic risks are a possible further reduction of net sales of foreign currency by individuals, enterprises’ precarious financial situation noted by the Central Bank, and continued uncertainty regarding potash fertilizer supplies to China.

Figure 23. Real BYN to USD Exchange Rate Gap (+ = the ruble is undervalued)

Table 2. Key Macroeconomic Indicators of the Republic of Belarus

<table>
<thead>
<tr>
<th>Indicators</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020F</th>
<th>2021F</th>
<th>2022F</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GDP in constant prices</strong> (% growth YoY)</td>
<td>2.5</td>
<td>3.1</td>
<td>1.2</td>
<td>-0.1</td>
<td>2.0</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>Consumer price index</strong> (% growth in December to previous year’s December)</td>
<td>4.6</td>
<td>5.6</td>
<td>4.7</td>
<td>5.3</td>
<td>4.5</td>
<td>4.0</td>
</tr>
<tr>
<td><strong>Nominal rate on overnight IBL in national currency</strong> (the year’s average % per annum)</td>
<td>9.5</td>
<td>10.7</td>
<td>10.1</td>
<td>9.0</td>
<td>8.4</td>
<td>8.1</td>
</tr>
<tr>
<td><strong>Nominal Belarussian Ruble to U.S. Dollar Exchange Rate, BYN per USD</strong> (the year’s average)</td>
<td>1.932</td>
<td>2.037</td>
<td>2.092</td>
<td>2.271</td>
<td>2.324</td>
<td>2.407</td>
</tr>
</tbody>
</table>

Источник: расчеты авторов, ЕЭК

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18 For more information see the report Ensuring Financial Stability in 2019 and the Objectives for 2020 delivered by Dmitry Kalechits, Deputy Chairman of the Board of the National Bank of the Republic of Belarus, at an extended Board meeting.
RESEARCH DEPARTMENT,
EURASIAN DEVELOPMENT BANK

Your comments and suggestions concerning this review are welcome at: pressa@eabr.org