CONTENTS

Information Disclosure .......................................................... 2
List of Abbreviations ............................................................ 3
SUMMARY ................................................................. 4
STATUS OF THE ECONOMY .................................................. 5
Economic Activity ............................................................... 5
The Labor Market ............................................................... 8
Inflation ...................................................................... 8
The External Sector ............................................................ 10
The Fiscal Sector ............................................................... 12
Monetary Conditions .......................................................... 14
ECONOMIC OUTLOOK ....................................................... 17
Background ................................................................. 17
Economic Activity ............................................................ 17
Inflation ...................................................................... 19
Monetary Conditions .......................................................... 19
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

BelNPP – Belarusian nuclear power plant

Belstat – National Statistical Committee of the Republic of Belarus

BYN – Belarusian ruble

EAEU – Eurasian Economic Union

EDB – Eurasian Development Bank

EEC – Eurasian Economic Commission

FDI – Foreign Direct Investment

GDP – Gross Domestic Product

IBC – Interbank Credit Market

MF RB – Ministry of Finance of the Republic of Belarus

NB RB – National Bank of the Republic of Belarus

pp – Percentage point

RB – Republic of Belarus

RF – Russian Federation

RUB – Russian Ruble

U.S. or USA – United States of America

USD – United States Dollar

% – Percent

% YoY – Year-on-Year growth rate
SUMMARY

In 2018, the Belarusian economy showed a high growth rate as it recovered after the recession in 2015–2016. Economic growth was supported by increasing consumer and investment activity as lending expanded, the population’s income grew, and the real sector’s economic sentiment improved.

The economic growth rate in 2018 gradually slowed down as the monetary conditions’ stimulating effect decreased and the low base effect petered out. The EDB predicts Belarusian GDP to increase annually by 1.5–2% in the medium term in the absence of additional stimulation.

The Belarusian ruble was highly volatile in 2018. The Belarusian currency was affected by aggravating geopolitical tension that caused the exchange rate of the Russian ruble and other EDB member countries’ currencies to fluctuate. In the medium term, the Belarusian ruble will devalue at a moderate rate as inflation in Belarus stays higher than in its main trade partner countries.

Inflation in 2018 kept within the NB RB’s target range, managed by a balanced monetary policy. Yet, after reaching its historic minimum in June and July 2018, inflation began accelerating in the second semester as food and fuel price growth increased and inflation in the RF accelerated while consumer demand remained high. The buildup of inflationary pressure led the NB RB to suspend its refinancing rate reduction cycle in 2nd half of 2018.

In 2019, inflation is expected to accelerate temporarily and perhaps exceed its end-of-year target level of 5%. Consumer price growth may be brought about by inflation increasing in the RF, gradual devaluation of the Belarusian ruble, and the persistent inflationary influence of wages. We predict this to be a temporary process, however, and in 2020 and 2021 inflation will be close to the NB RB’s targets. The IBC rate is expected to be in the 10–11% range, which is consistent with its neutral level.

The Republic’s budget surplus expanded considerably in 2018 due to temporary factors, including commodity price growth and a high recovery growth rate in the national economy. The budget surplus reduced the country’s need to refinance its public debt. In the medium term, the budgetary and fiscal policy will remain focused on the improvement of fiscal and debt stability.
STATUS OF THE ECONOMY

Economic Activity

Economic growth accelerates

In 2018, the Republic of Belarus observed the highest economic growth rate since 2011. National GDP increased by 3% after 2.5% in 2017. The Belarusian economy thus completed its recovery phase after the recession of 2015–2016, as indicated in particular by the output gap reading, which was near zero in 2018. Households’ consumer activity was a key factor behind the acceleration of economic growth in 2018. Industrial output remained a positive contributor to GDP growth. Agriculture, by contrast, constrained economic growth.

GDP growth continued to decelerate in 2018 as the low base effect petered out and the economy reached a state of equilibrium. In August to December 2018, the average monthly GDP growth rate versus the same month the previous year was around 1.1% according to our calculations, while in January to July 2018 it was 4.6%.

Figure 1. Economic Activity

Source: Belstat, authors’ calculations
Consumer activity expands

Consumer demand was the main driver of economic growth in 2018. That year, retail sales increased by 8.4% after 4.4% in 2017. The expansion of consumer activity was due to growing household incomes and lending. In 2nd half of 2018, retail sales growth began to decelerate gradually as the population’s borrowing activity slowed, which may point to the gradual satisfaction of deferred demand that built up in 2015 and 2016.

Investment activity increases

Investment growth remained at the preceding year’s level. The growth rate in fixed capital investment was 5.1% in 2018. The most rapid increase in investment was observed in 1Q2018 as individual infrastructural components of BelNPP began operation. In addition to investment in BelNPP, the factors behind the expansion of investment activity in 2018 included the growth of lending and businesses’ improving economic sentiment. Notable among the positive results of 2018 was the decrease in the share of imported machines, equipment and vehicles in fixed asset investments in use, to 64.1% from 67.1% in 2017.

Figure 2. Retail Sales and Investment (growth YoY)

Source: Belstat

Industrial output increases

Industry made a considerable contribution to economic growth in 2018. According to the Belstat, industry provided 1.4 pp of 2018 GDP growth. Industrial output grew rapidly in 1st half of 2018 against a low base, supported by an expansion in lending and the effect of the weakening of the Belarusian ruble in late 2017 and 1Q2018. In 3–4Q2018, lending to enterprises began to slow, while the strengthening of the real effective exchange rate reduced Belarusian goods’ price advantage. As a result, the industry growth rate slowed to 5.7% in 2018 overall (from 6.1% in 2017).

Agricultural output declines

The agricultural output decline in 2018 constrained economic growth. Agricultural output decreased by 3.4% that year (after 4.2% growth in 2017), largely due to a low harvest of staple crops caused by bad weather in 2018. Thus, the gross yield of
Foreign trade’s contribution to GDP growth remains negative

According to Belstat, imports of goods grew in volume terms by 5% in 2018, while export volumes increased by 4.8% (vs. growth of 13.3% and 8.4%, respectively, in 2017). This indicates that net exports’ contribution to Belarusian GDP growth remained negative in 2018. Export and import volumes of goods were mostly on a downward trend during 2018. The slowdown in exports in 2nd half of 2018 was partially due to the strengthening of the real effective exchange rate of the Belarusian ruble. The import growth rate of goods declined towards the end of 2018 as consumer and investment demand growth slowed.
The Labor Market

Household income and wages growing

The increase in household incomes helped to drive consumer demand. Real disposable incomes increased by 8% in 2018 (after 2.8% growth in 2017). Wages were the key factor behind the growth in household incomes. They grew by 11.6% in real terms in 2018 after 7.5% the year before. Wage increases during economic recovery are a natural process, but wages growth in 2018 was well ahead of labor productivity growth. On the one hand, that stimulated consumer activity, but, on the other hand, a high and persistent wages growth rate increases inflationary risks. Besides wages, the growth in incomes in 2018 was also driven by increasing nominal allocated pensions, which grew by 14.8% that year (after 1.2% growth in 2017).

Unemployment decreases

The level of unemployment fell in 2018. According to Belstat, the unemployment level was 4.8% at the end of 2018 (5.6% at the end of 2017).

Inflation

Inflation increases in 2nd half of 2018

Inflation accelerated in 2018 but remained within the NB RB’s target. The consumer price index growth rate in December 2018 was 5.6% YoY, up from 4.6% YoY in December 2017. Accelerated price growth was observed in both food and non-food goods segments. Core inflation rose from 2.5% YoY in December 2017 to 4.8% YoY in December 2018. The increase in inflation in 2018 resulted from the exhaustion of the disinflationary effect of domestic demand as well as some temporary factors (mainly the low harvest of 2018).
Food price growth accelerates

Food prices increased by 5.7% YoY in December 2018 after 4.2% YoY in December 2017. Food inflation increased largely on account of faster growth of meat and meat product prices, which increased by 11.6% in the reporting year after decreasing by 1.8% the year before. The 2018 trends in meat product prices were shaped by the low grain harvest that resulted in higher feed prices. This factor has only a temporary effect on inflation, but accelerated food price growth may continue until the new harvest is collected.

Deflationary effect of domestic demand weakens

Non-food prices increased by 3.8% YoY in December 2018 after 2% growth in December 2017. Inflation in this segment was accelerated by consumer activity growth and accelerated inflation in the RF. A significant factor behind more intensive growth of non-food prices was fuel price appreciation resulting from the growth in world energy prices.

The service price growth was 8.1% in 2018 after 9.5% the year before. The slowdown was mainly on account of lesser growth in utility prices and fares in 2018 compared to 2017. Despite the slowdown, service price growth is still well ahead of price growth in other segments of the consumer basket.
Inflationary expectations still high

The population’s inflationary expectations rose in 2018. According to the NB RB, in November 2018 the population expected 12.6% inflation in the following twelve months, 0.7 pp higher than in November 2017. The increase in inflationary expectations probably resulted from accelerating growth of food and fuel prices and from the weakening of the Belarusian ruble against the U.S. dollar and euro in 2nd half of 2018.

The External Sector

Smaller deficit on current account of balance of payments

The negative balance on the current account of the balance of payments was USD 265.6 million (0.4% of GDP) in 2018, down from USD 945.2 million (1.7% of GDP) the year before. The increased surplus of foreign trade in goods and services (USD 693.8 million in 2018 after USD 82.9 million in 2017) did the most to reduce the current account deficit. The foreign trade surplus expanded on account of both the growing surplus of trade in services and the decreasing deficit of trade in goods. The trade surplus in services reached USD 3,345.1 million in 2018, USD 283.3 million more than last year. It expanded mainly due to high growth in computer service exports.

Figure 8. Balance of Payments (four quarters’ moving total)

Source: Belstat, NB RB, authors’ calculations

Improved goods trade balance

The trade deficit was USD 2,651.3 million in 2018, or USD 327.6 million less than in 2017. The deficit decreased as the terms of trade remained favorable and goods exports grew at a higher rate than imports in monetary terms. Thus, according to the Belstat, in 2018 export goods’ prices grew at an average rate of 10.1%, compared to 6.9% for import prices. The prices of Belarusian exported goods were strongly supported by higher oil prices in the world market and by growing potash fertilizer prices.
Goods exported to third countries growing at a faster rate than exports to EAEU

Belarusian goods exports increased primarily on account of growing supplies to non-EAEU countries. According to EEC statistics, Belarusian exports to third countries grew by 27.2% in 2018, while exports to the EAEU increased by a mere 1.8% (exports to the RF increased by 0.4%). As a result, the share of mutual trade in Belarusian exports decreased by 3.1 pp, to 41.3% in 2018. The expansion of exports to third countries was driven by the increasing monetary value of oil products and potash exports as their prices grew. Also, the weakening of the Belarusian ruble versus the U.S. dollar and euro supported Belarusian exporters targeting the European Union’s market, while its strengthening against the Russian currency limited the competitive advantages in the Russian market.

The inflow of FDI increased. According to the Belstat, net FDI in the real sector of the economy (excluding debt owed to direct investors for goods/works/services) was USD 1,634.9 million in 2018, 31.1% (or USD 388.1 million) more than the year before. FDI growth may have been supported by the country’s improved credit rating and by a balanced economic policy that maintained macroeconomic and financial stability in RB.
Forex reserves low

The country’s international reserves decreased due to high payments on foreign currency liabilities. On 1 January 2019, the forex reserves were USD 7,157.6 million, or USD 157.7 million less than a year before. The decrease of the reserves in 2018 was caused by the repayment of the Government’s and NB RB’s foreign currency liabilities (some USD 5.7 billion). According to the NB RB, the growth of the State budget’s revenues from oil product exports helped replenish the reserves. In early 2019, the international reserves could support some 2.1 months of imports of goods and services, while staying below the traditional sufficiency criterion (three months’ imports of goods and services).

Figure 10. Belarusian Exported Goods
(four quarters’ total growth rate vs. the preceding four quarters’ total)

Source: EEC, authors’ calculations

Figure 11. Belarus’ International Reserve Assets

Source: NB RB, authors’ calculations

The Fiscal Sector

Budget surplus expands

In 2018, the Republic’s budget posted a surplus of 3.8% of GDP, up from 2.6% of GDP the year before. The factors behind the surplus growth were mainly temporary and related to the market situation. The budget’s revenues increased at a faster
rate than its expenses, largely on account of increasing revenue from foreign trade and indirect tax revenues. The growth in revenue from foreign trade was driven by rising prices of key Belarusian export commodities, i.e. oil and potash fertilizers. The increase in indirect tax revenues in 2018 mainly resulted from growing economic activity. With the economy approaching equilibrium and slowing down to its potential growth rate, no substantial increase in indirect taxes is expected in 2019.

**Public debt stays at safe level**

Public debt in absolute terms increased mainly on account of borrowings from the RF and Chinese banks. On 1 January 2019, the public debt of Belarus was 45.4 billion rubles, 7.6% more than the year before. Its growth was due to the increase in foreign liabilities, which grew by USD 0.2 billion in 2018 to reach USD 16.9 billion in early 2019. Domestic debt was reduced by 0.3 billion rubles, to 8.9 billion rubles on 1 January 2019. The increase in the BYN equivalent of public debt was also due to the weakening of the Belarusian ruble vs. the U.S. dollar. The debt to GDP ratio was 35.4% as of 1 January 2019, so it was below the safety limit (no more than 45% of GDP) established by the Strategy of the Republic of Belarus for the Management of Public Debt in 2015–2020.

**Belarus’ credit rating improved**

In February 2018, the RB placed USD 600 million’s worth of Eurobonds at 6.2% for 12 years. The coupon rate was a historic minimum for the RB in the Eurobond market. The price of borrowing was reduced after Fitch raised the country’s sovereign credit rating to B with a ‘stable’ outlook and RB was moved from the seventh to the sixth risk group in the OECD classification.

**Large payments on public debt in 2019**

In 2019, the amount of repayments and servicing of public debt will be some USD 3.9 billion. Payments on foreign public debt, about one-half of which is due for RF loans, will account for more than 60%. The sources of funding for public debt expenditures are expected to include the Republic’s budgetary surplus in the amount of 1.7 billion rubles planned by the authorities.
The refinancing rate was lowered by 1 pp during the year, to 10% by the end of 2018. The refinancing rate was reduced in 1st half of 2018 as inflation was low and reached its historic minimum by July 2018. In August, the inflation risks grew due to the aggravation of geopolitical tension in the region, followed by increased exchange rate volatility. Against this backdrop, the NB RB suspended its monetary policy easing cycle and left the refinancing rate unchanged at its meetings in September and December 2018.

The IBC interest rate was around the refinancing rate in 2018. From January 2018, the NB RB switched to using the interest rate on overnight interbank loans as its operational target instead of the BYN monetary base that had been used since 2015.
The increase in the IBC rate at the end of 2018 in excess of the refinancing rate may have resulted from higher inflationary expectations. On average, in 2018 the IBC rate kept near its neutral level.

**More lending**

Bank lending accelerated on account of the retail segment. Loans to the economy grew by 13.7% in 2018, versus 8.1% in 2017. Increasing credit activity was supported by economic agents’ growing demand for credit and by the easing of banks’ lending conditions. Lending to the population was the greatest contributor to the growth of the banks’ credit portfolio and it grew by 28.4% in 2018 (versus 26.2% in 2017) to account for almost 50% of the total expansion of the credit portfolio. Retail lending was driven by growth in real estate loans (up 19.7% in 2018) and consumer loans (up 45.7%). It should be noted that retail lending growth began to decelerate in 2nd half of 2018, which may indicate that pent-up demand in the economy is gradually being satisfied.

**Figure 15. Factors’ Contribution to the Growth of Banks’ Credit Portfolio (end of quarter YoY change)**

Source: NB RB, authors’ calculations

**Loans and deposits less dollarized**

The dollarization of bank loans and deposits continued to decrease in 2018. The share of foreign currency loans to enterprises among all bank loans to enterprises was 64.1% at the beginning of 2019, 0.6 pp less than a year before. The dollarization of bank deposits decreased by 2.2 pp during the same period, to 64.9% at the beginning of 2019. Notwithstanding this decrease, the dollarization of financial contracts remains one of the highest in the region, which limits the effectiveness of monetary policy and leaves the real sector of the economy exposed to foreign exchange risks.

**Net supply of foreign currency declines in domestic forex market**

Net supply in the domestic foreign exchange market declined in 2018. Individuals and businesses sold a combined USD 443 million net in 2018, around half as much as in 2017 (USD 879 million). This difference resulted from growing foreign currency purchases by the population, which may be explained by increasing household...
Businesses reduced their net purchases of foreign currency in 2018, especially in the second semester, possibly as the growth of imported goods and services slowed in 2018.

There were mixed movements in the main currency pairs in 2018. Following the Russian currency, the Belarusian ruble weakened versus the U.S. dollar and euro. Yet the Belarusian ruble strengthened considerably against the Russian ruble, which boosted its nominal effective exchange rate in 2018. The BYN to RUB strengthening resulted from continued net supply in the domestic forex market and the use of the basket of currencies by the NB RB in implementing its exchange rate policy.

The real effective exchange rate of the Belarusian ruble strengthened in 2018. Its growth results from the strengthening of the Belarusian ruble versus the Russian ruble and Belarusian inflation remaining higher than in Belarus’s main trade partner countries. The growth of the real effective exchange rate of the Belarusian ruble has made Belarusian producers’ less price-competitive, but also reduced the external sector’s inflationary pressure.

**Figure 16. Belarusian Ruble Exchange Rate**
*(growth rate year on year, + = ruble strengthening)*

Source: NB RB, authors’ calculations
ECONOMIC OUTLOOK

Background

External demand slows while imported inflation increases

According to our estimates, in 2019 the oil prices will regain some of the ground lost in late 2018: the average Urals price is expected to be around USD 65 per barrel. External demand is expected to slow down somewhat, mainly because of the projected slowdown of the Russian and Euro Zone economies. The external sector’s inflation pressure will grow as inflation accelerates in RF. Turning to U.S. sanctions rhetoric in respect of RF, the projected scenario assumes the current sanctions to persist throughout the projection horizon.

Domestic economic policy to prioritize sustainable growth

The projection scenario assumes fiscal policy’s continued focus on keeping both the budget and public debt sustainable. Monetary policy will prioritize meeting the inflation target, which we project at 5% in 2019–2020 and 4% in 2021 and later.

Table 1. Forecast Key Foreign Economic Indicators

<table>
<thead>
<tr>
<th></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, % (the year’s average)</th>
<th>Inflation in the Euro Zone, % (the year’s average)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>65.0</td>
<td>1.5</td>
<td>1.3</td>
<td>5.0</td>
<td>1.3</td>
</tr>
<tr>
<td>2020</td>
<td>64.7</td>
<td>2.0</td>
<td>1.7</td>
<td>4.2</td>
<td>1.8</td>
</tr>
<tr>
<td>2021</td>
<td>63.4</td>
<td>2.2</td>
<td>1.7</td>
<td>4.0</td>
<td>1.9</td>
</tr>
</tbody>
</table>

Source: authors’ calculations, EEC

Economic Activity

Economy to slow down in 2019

The completion of the economic recovery phase will reduce the country’s GDP growth rate to 1.5% in 2019. Consumer demand is projected to slow as the wages growth rate and the population’s credit activity decline. Investment activity will be constrained by the banks’ lending terms, which will not be eased any further. The economic slowdown that we expect in the RF and Euro Zone may result in a slowdown of growth in Belarusian goods exports. Fiscal policy will have a neutral effect on economic activity in the projection horizon.
Geopolitical tension in the region remains the key risk for the Belarusian economy in 2019. Due to close trade and economic relations between RB and the RF Federation, any potential tightening of sanctions against the RF may affect economic activity in the RB as well.

Near-potential growth in medium term

We expect annual growth of Belarusian GDP in 2020–2021 to be around 2%, which is its potential rate. The potential economic growth rate may increase as the Government implements its business environment liberalization initiatives and the country becomes more attractive for investors. The Small and Medium-Sized Business Development Strategy approved in October 2018 is aimed at improving the conditions for doing business and thus making the Belarusian economy more competitive, which is a positive step in this direction.

1 Here and elsewhere the fan chart ranges correspond to the 10%, 50% and 75% confidence intervals.
2 Seasonally adjusted data.
Inflation

Inflation to Increase temporarily in 2019 and then approach target in medium term

We project inflation to increase in 2019 to reach 5.7% by the end of the year and to settle above the NB RB’s target (not more than 5%). Accelerated growth in consumer prices will be driven by the acceleration of inflation in the RF, gradual weakening of the Belarusian ruble and continued inflationary pressure from wages. We estimate the said factors’ effect to be temporary and consumer price growth to gradually slow down to its target rate in the medium term. Inflation risks remain weighted towards the pro-inflation side. There remains a risk of a further increase in domestic fuel prices as oil prices recover to their average 2019 level.

Figure 19. Inflation³ (for each period, YoY)

Source: authors’ calculations, EEC

Monetary Conditions

Interest rate policy to remain neutral

We estimate the IBC interest rate to be in the 10–11% range in 2019. Interest rates kept near their neutral levels will help normalize the lending growth rate, primarily in the retail segment, which is needed to prevent substantial deviation of inflation from the target. In the medium term, the IBC rate may decrease to 9.5–10% as inflation and its expectations decrease.

³ Seasonally adjusted data.
Belarusian ruble likely to weaken

The Belarusian ruble is projected to weaken in 2019 at a moderate rate that will keep Belarusian manufacturers price-competitive. The Belarusian ruble’s downward trend will continue in the medium term, as inflation in the RB is expected to be higher than in its main trade partner countries.

Source: authors’ calculations, EEC

The main risks to the exchange rate are essentially geopolitical. The foreign currency market is the first to respond to changes in sanctions rhetoric, and the BYN to USD trends are closely correlated to movements in the Russian ruble’s exchange rate.
### Key Macroeconomic Indicators of the RB

<table>
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</thead>
<tbody>
<tr>
<td><strong>GDP in constant prices</strong> (%) growth YoY</td>
<td>-2.5</td>
<td>2.5</td>
<td>3.0</td>
<td>1.5</td>
<td>1.9</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>Consumer price index</strong> (%) growth in December to previous year’s December</td>
<td>10.6</td>
<td>4.6</td>
<td>5.6</td>
<td>5.7</td>
<td>5.0</td>
<td>4.0</td>
</tr>
<tr>
<td><strong>Nominal rate on overnight IBC in national currency</strong> (% per annum)</td>
<td>20.6</td>
<td>9.5</td>
<td>10.7</td>
<td>10.6</td>
<td>10.7</td>
<td>10.1</td>
</tr>
<tr>
<td><strong>Nominal Belarusian Ruble to U.S. Dollar Exchange Rate, BYN per USD</strong> (%)</td>
<td>1.989</td>
<td>1.932</td>
<td>2.037</td>
<td>2.182</td>
<td>2.278</td>
<td>2.348</td>
</tr>
</tbody>
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*Source: authors’ calculations, EEC*

**Figure 22.** Real BYN to USD Exchange Rate Gap (+ = the ruble is undervalued)

*Source: authors’ calculations, EEC*
RESEARCH DEPARTMENT,
EURASIAN DEVELOPMENT BANK

Your comments and suggestions concerning this review are welcome at:
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