

REPUBLIC OF BELARUS

Social and Economic Development in 2022

May 2023

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The EFSD does not publish its opinion on the section "Budget sector and public debt" due to the fact that budget data is provided by the Belarusian side to the EFSD with the stamp "For official use".

The materials presented may not coincide with the official opinion of the EDB and the EFSD governing bodies.

May 2023

LIST OF ABBREVIATIONS

BMS – broad money supply

CA – current account of the balance of payments

CIS – Commonwealth of Independent States

EFSD Project Unit – Project Unit of the Eurasian Fund for Stabilization and Development

FAO – Food and Agriculture Organisation of the United Nations

FDI – foreign direct investment

GDP – gross domestic product

GIR – gross international reserves

ILO – International Labour Organisation

MF RB – Ministry of Finance of the Republic of Belarus

NBRB – National Bank of the Republic of Belarus

RB – Republic of Belarus

RF – Russian Federation

SPF – Social Protection Fund

US – United States of America

VAT – value added tax

SUMMARY

The negative impact of sanctions, along with high external background inflation, drove the economy of the Republic of Belarus into stagflation in 2022. Real GDP fell by 4.7%, while inflation accelerated to 12.8%. However, the macroeconomic performance in H2 is indicative of gradual adaptation of the Belarusian economy to the new environment. The GDP slump started to slow down. That was accompanied by significant deceleration of inflation, although it was partly achieved through tightened administrative price controls.

Despite a decline in export volumes due to sanctions, a favourable external environment, emerging alternative markets, and expanded trade with Russia, along with restrained imports, ensured the stability of the balance of payments against the background of capital outflows.

Monetary policy was aimed at stabilising inflation expectations, ensuring financial stability, and supporting the economy.

Under the baseline scenario of the EFSD Project Unit, in the medium term, the Belarusian economy would continue to operate under the pressure of sanctions. In 2023, the economy is expected to show recover growth by 2.5%, followed by a slowdown to 0.8%. In 2023, fiscal policy would continue to support the economy by raising salaries and wages in the budget sector, with consolidation expected in 2024 and 2025.

The need to repay and service Government debt obligations would be a key factor of pressure on the fiscal accounts and the balance of payments. According to the EFSD Project Unit, the RB has sufficient internal reserves to finance the fiscal gap in 2024–2025, without disturbing the macroeconomic balance, by issuing domestic government debt obligations.

Real Sector and Labour Market

In 2022, the Belarusian economy operated in the environment of negative external shocks, which resulted in a marked downturn in economic activity. Real GDP fell by 4.7% in 2022, against growth by 2.4% in 2021. The main channels of the negative impact on the economy were an expansion of sanctions, limited access to external sales and capital markets, and disruption of production and logistics ties. According to estimates prepared by the EFSD Project Unit, the deepest downturn of seasonally adjusted real GDP was observed in Q2¹ (about 6%) with a partial recovery in H2 (by 2% in Q3 and 0.5–1% in Q4 2022), which may indicate a gradual adjustment of the Belarusian economy to the new operating environment by the end of 2022.

A negative contribution to the GDP dynamics was made by all major components, including: net exports (-2.0 p.p.), gross capital formation (-1.9 p.p.), and consumption (-0.9 p.p.). The contribution of net exports was affected by exports (-18.9%) dropping at a faster pace in constant prices compared to imports (-16.2%), which was largely attributable to the restrictions imposed on key export items (petroleum products, potash fertilizers), as well as to the overall weakening of both external and domestic demand against the background of sanctions and lower household incomes (Figure 1).

In the face of increased pressure of sanctions, fixed investment contracted by 19.0% compared to the corresponding period of the previous year (against a decrease of 5.6% a year earlier). The largest contraction occurred in investment in machinery, equipment, and vehicles (-29.5%); while investment in construction and installation works fell by 13.5%. Lower investment financing was registered for almost all sources, with the largest drop in bank lending (-39.9%), companies' own funds (-22.2%), and the national budget (-20.9%).

Negative dynamics of consumer activity was driven by a decrease in real disposable incomes of households by 3.6% (against an increase of 2.0% a year earlier), restrained consumption of the general government sector (-1.7%), and a contraction in consumer lending. The consumer loan portfolio of banks contracted by 5.2% in nominal terms in 2022. Real retail trade fell by 3.7% in 2022 (against an increase of 2.0% a year earlier).

In terms of sectors, the most significant contribution to the economic downturn was made by industry (-1.5 p.p.), trade² (-1.2 p.p.), transport (-0.9 p.p.), and construction (-0.6 p.p.) (Figure 2). In addition, a negative contribution to the real GDP growth (-0.2 p.p.) was made by the IT sector, which used to be one of the most important drivers of economic growth in previous years. Only agriculture made a positive contribution to the real GDP growth (+0.3 p.p.); it grew by 4.4% (against a decline of 4.8% a year earlier) given higher grain yields. There was a decline in manufacturing output (-6.4%), largely attributable to export restrictions and weaker external demand. However, a build-up in inventories slightly reduced the magnitude of the downturn in industry – on average, the inventories of the manufacturing industry went up to 79.0% of the average monthly output in 2022 against 60.2% a year earlier. In that environment, there was a slight deterioration in the financial position of industrial enterprises, which was reflected in a decrease in net profits by 2% in nominal terms. However, the position of loss-making entities deteriorated substantially, with their net losses up by a factor of 3.2 in 2022 (to BYN 2.7 billion against BYN 0.8 billion a year earlier).

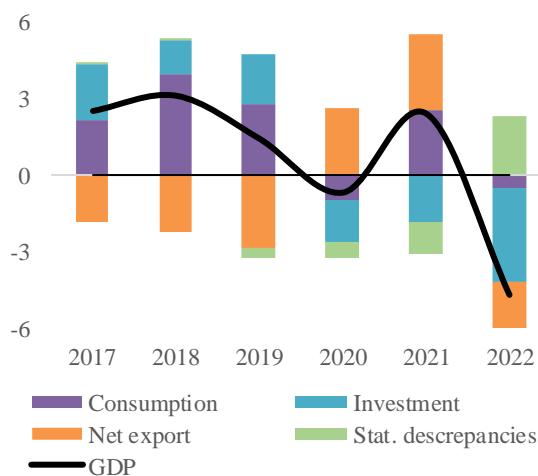
¹ The ratio of the real GDP for the quarter, net of seasonal effects, to the corresponding value for the previous quarter.

² To a large extent, due to a 17.8% decrease in wholesale trade.

The labour market saw a faster decline in the number of employed persons, accompanied by a slight decrease in unemployment amid lower labour supply. The rate of decline in the average annual number of persons employed in the economy doubled (1.6% against 0.8% a year earlier). The largest contribution to lower employment was made by three sectors that experienced the fastest decline in the average payroll number of employees: construction (-8.1%), transport (-4.3%), and agriculture (-3.2%). In 2022, this group also included the IT sector, which saw a significant reduction in the number of persons employed, which started in April, reaching 3.7% for the whole year (against 4.6% growth a year earlier). Despite a decline in output, there was even a slight decline in the unemployment rate (according to the ILO methodology) to 3.6% from 3.9% a year earlier. The key reason for the simultaneous decline in both employment and unemployment was a drop in the active labour force, associated with the aging of the population (see the Box below), and outward labour migration from the Republic of Belarus. According to a household sample survey made by Belstat, the number of citizens employed outside the RB grew by 9.6% in 2022.

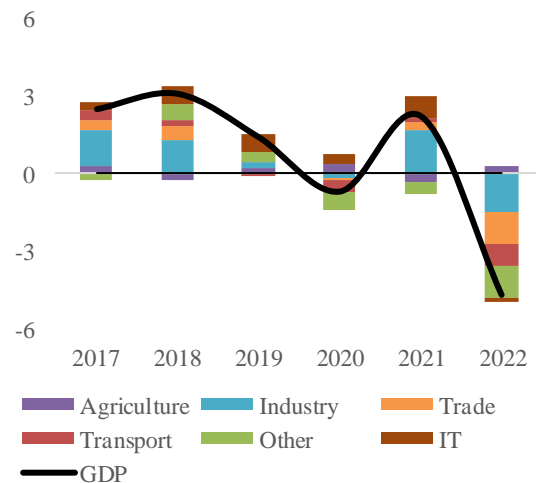
Real wages declined by 1.8% in 2022 (against an increase by 5.1% a year earlier). The highest rates of their reduction occurred in the health sector (-9.5%), construction (-3.6%), and IT (-6.5%). The main factors contributing to that trend included a reduction of supplementary payments to health care workers due to an improvement in the epidemiological situation, a significant drop in construction volumes, and the relocation of highly paid IT specialists abroad.

Figure 1. Contribution to GDP growth, by use components (p.p., y-o-y)



Source: Belstat

Figure 2. Contribution to GDP growth, by production components (p.p., y-o-y)



Source: Belstat

Inflation and Monetary Policy

A rise in global commodity prices, higher logistics costs, depreciation of the Belarusian rubel against the Russian ruble, and high inflation expectations led to an acceleration of inflation in 2022. In December 2022, the increase in consumer prices was 12.8% against 10% at end-2021, which significantly exceeded the target of no more than 6% declared by the NBRB for 2022. Core inflation accelerated to 14% (against 9.8% at end-2021). The contribution of food price growth to the increase in the overall inflation was 6.0 p.p., that of non-food – 4.4 p.p., and that of services – 2.4 p.p. The largest surge in prices was recorded in Q1 2022, while in subsequent quarters, their growth gradually slowed down due to stabilisation of the exchange rate and weak domestic demand. In particular, while the annualised inflation

rate³ was estimated by the EFSD Project Unit at about 35% in the Q1 2022, it slowed down to single digits in H2, with even some deflation in Q4. An expansion of the scope of state regulation of consumer prices for almost all types of goods⁴ had a significant impact on price dynamics at the end of the year. According to a household survey, inflation expectations fell to 12.6% by the end of 2022, against 15.7% in June 2022, and 14.2% in December 2021.

The NBRB's monetary policy was aimed at balancing the goals of preventing a steady increase in inflation expectations, ensuring financial stability, and supporting the economy. The magnitude and scale of the shocks affecting the economy in early 2022 caused significant volatility in the foreign exchange and financial markets. To limit the risks of mounting inflation expectations and stabilise the exchange rate, the NBRB raised the refinancing rate from 9.25% to 12% per annum starting from March 1, and performed active foreign exchange interventions. The net demand for foreign exchange by market participants amounted to US \$0.7 billion in February–March 2022. Later on, as markets stabilised and the negative output gap increased⁵, the monetary authorities focused mainly on supporting the economy by easing the lending conditions through money supply expansion. Starting in April, despite a significant contraction of exports, favourable price conditions and a significant drop in imports contributed to the formation of net supply of foreign exchange in the domestic market generated by its participants. In April–December 2022, the net supply of foreign exchange by market participants amounted to US \$1.2 billion. Under such conditions, the NBRB actively purchased foreign exchange on the domestic market, which resulted in excess short-term BYN liquidity. An important factor driving the excess liquidity was also money emission by the NBRB through the credit channel, demonstrated by an increase in claims on the Central Government (by BYN 4.2 billion) and the Development Bank of the Republic of Belarus (by BYN 1.7 billion). At the same time, it should be noted that excess liquidity formed partly as a result of repayment by banks of loans received from the NBRB in 2020–2021 (BYN 2.2 billion), as well as accumulation of Government deposits in the NBRB (BYN 2.4 billion). In general, in the absence of NBRB operations to sterilise liquidity, the BYN base money grew by 26.1% in 2022 against 12.4% a year earlier, while nominal interest rates on the money, credit and deposit markets fell below the level of February 2022. In December 2022, the overnight interbank credit interest rate was 1.0% per annum, the interest rate for new term deposits was 3.3% per annum⁶, and that for new BYN loans was 10.3% per annum.

The BMS grew by 12.7% in annual terms in 2022 against 7.0% in 2021. The BYN money supply continued to grow at an accelerated rate (25% in annual terms in December 2022), which, for the first time since 2011, led to its share in the BMS exceeding that of the foreign exchange component. At the same time, with the interest rates for term deposits going down, there was accelerated growth of transferable deposits of enterprises within the BYN money supply (by 51%) and that of cash in circulation (by 46%).

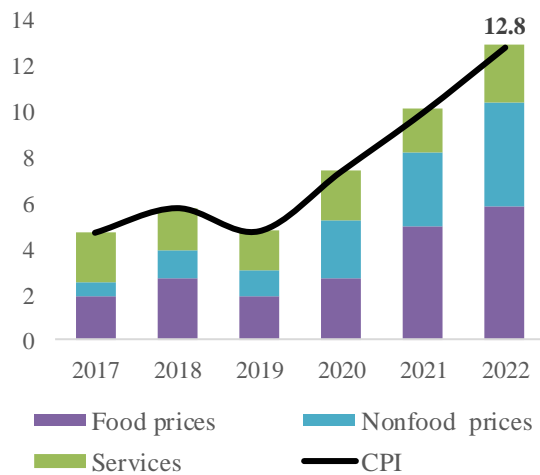
³ The annualised inflation rate is the seasonally adjusted rate of price growth for a quarter, converted to an annual value by raising it to the 4th power. This indicator gives a sense of what the annual inflation could be if the quarterly rate of price growth in the economy persists throughout the year.

⁴ Resolution of the RB Council of Ministers No. 713 "On Price Regulation System" dated 19 October 2022.

⁵ According to NBRB estimates

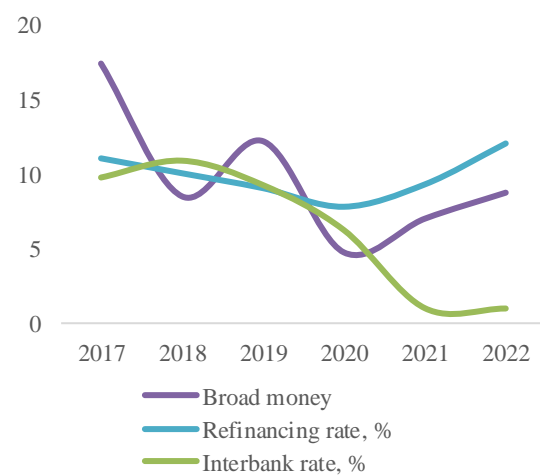
⁶ Formed mainly due to a reduction of the deposit interest rate for legal entities to 1.6% per annum, while the interest rate for private individuals was 9.9% per annum.

Figure 3. Inflation
(in %, y-o-y, end of period)



Source: Belstat

Figure 4. Dynamics of monetary indicators
(in %, y-o-y, end of period)



Source: Belstat, NBRB

External Sector

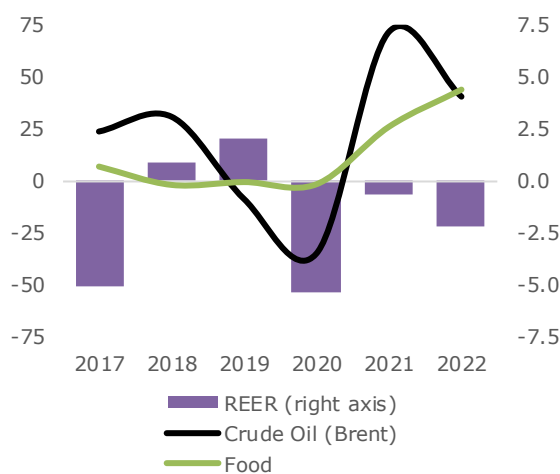
Despite a significant drop in exports, lower imports and favourable price conditions contributed to the formation of a higher trade surplus and maintaining a CA surplus in Belarus. In 2022, the CA surplus increased to US \$2.7 billion, or 3.6% of GDP (against US \$2.2 billion, or 3.1% of GDP in 2021). A faster rate of reduction of imports in value terms (-6%) relative to exports (-4%) of goods contributed to the formation of a merchandise trade surplus of US \$172 million, or 0.2% of GDP (against a deficit of US \$667 million or 1.0% of GDP a year earlier). A marked effect on exports in value terms was generated by favourable price terms of trade (Figure 7), manifested in depreciation of the real exchange rate of the Belarusian rubel against the Russian ruble (by 10%) and an increase in export prices to the RF in US dollar terms against the background of appreciation of the Russian ruble against the US dollar. It was accompanied by an increase in the share of the CIS countries, mainly the RF, in exports to 68.1% from 59.9% a year earlier. In turn, the surplus of trade in services decreased to US \$4.1 billion, or 5.7% of GDP (against US \$4.6 billion, or 6.8% of GDP a year earlier). The dynamics of trade in services was probably affected by a decrease in freight turnover and a contraction in the IT sector. In terms of primary incomes, the deficit remained at US \$2.5 billion (about 3.5% of GDP) (Figure 8).

Under the financial account of the balance of payments, the outflow of funds amounted to US \$2.7 billion in 2022 (3.7% of GDP). In addition to external debt repayment by the Government, the outflow occurred in the banking sector and in the sector of enterprises. Banks' net foreign assets increased by US \$2.0 billion (-2.8% of GDP) in 2022 against their growth by US \$0.5 billion (-0.7% of GDP) a year earlier. The debt of Belarusian enterprises associated with trade credit and advances received from non-residents decreased by US \$0.7 billion (0.9% of GDP), which is presumably due to tougher payment requirements set by foreign suppliers in the context of sanctions and a general decline in imports of goods and services. At the same time, the promotion of exports could have resulted in softer payment terms set by the Belarusian side, which led to an increase in receivables by US \$0.7 billion (1.0% of GDP). The overall outflow under the financial account was constrained by the introduction by the authorities of restrictions on the repatriation of dividends by foreign

investors⁷, which was reflected in an increase in reinvested incomes (from 1.0 to 1.5% of GDP).

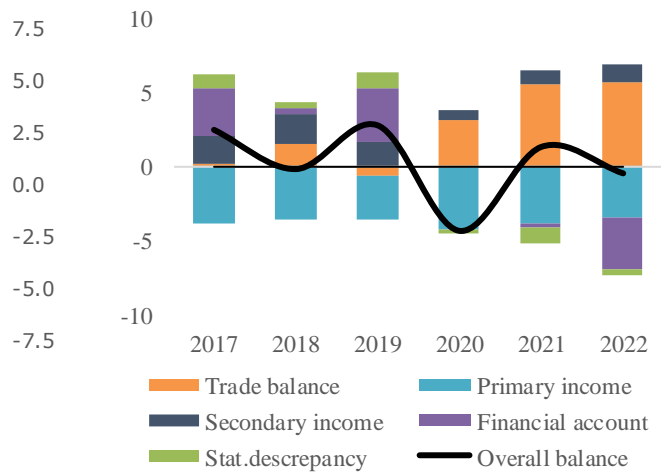
The gross international reserves decreased by US \$0.5 billion in 2022 and amounted to US \$7.9 billion, or 2.2 months of imports, as at 1 January 2023. The key factor contributing to the decline in reserves was the repayment of external and domestic foreign currency liabilities by the Government. The NBRB purchased foreign exchange when there was net supply of currency on the foreign exchange market that helped maintain the level of reserves.

Figure 7. Dynamics of price terms of trade (in %, y-o-y)



Source: WB, FAO, Belstat, NBRB

Figure 8. Balance of payments (in % of GDP)



Source: NBRB, Belstat

Financial Sector

Lending remained subdued in 2022, despite easing of monetary conditions and an expansion of financing provided by the Development Bank. In 2022, claims of banks and the Development Bank grew by 4.4% in annual terms against an increase of 5.0% as at end-2021 (or 1.7% and 5.6%, net of the exchange rate effect, respectively). During the year, banks' claims (excluding the Development Bank) on the economy increased by 2.4% (against 2.7% in 2021), mainly due to an increase in BYN claims by 19.2%, while claims in foreign exchange fell by 22.4% (Figure 9). Important constraints on expanding lending included a high level of debt pressure on borrowers, as well as lack of promising investment projects in the context of sanctions. That is, despite significant amounts of excess liquidity, the banking sector was prudent and took a balanced approach to assessing the risks of project financing. The growth of BYN lending was mainly driven by an increase in short-term debt, probably to replenish the working capital of business entities. In general, the growth of banks' BYN loan portfolio was formed by lending to state-owned enterprises (up by 40%) and the private sector (up by 28.5%), while consumer lending declined (-5.2%). The dollarization of claims of banks and the Development Bank on the economy decreased significantly, amounting to 38.2% against 47.0% at the beginning of the year⁸.

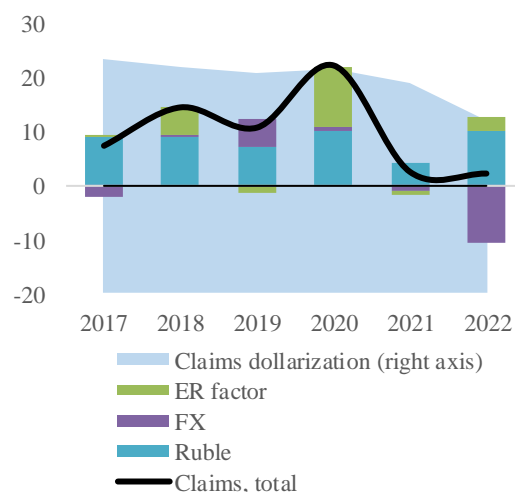
⁷ In accordance with the Presidential Decree, the Government was authorised to establish a higher tax rate on incomes of foreign entities in relation to potential payments (dividends, royalties, interest income, etc.)

⁸ A dollarization rate below 40% was last registered at end-2011.

As the net financing of directed loans was negative, their share in total claims of banks and the Development Bank on the economy fell from 13.2% at the beginning of 2022 to 8.8% for 2022.

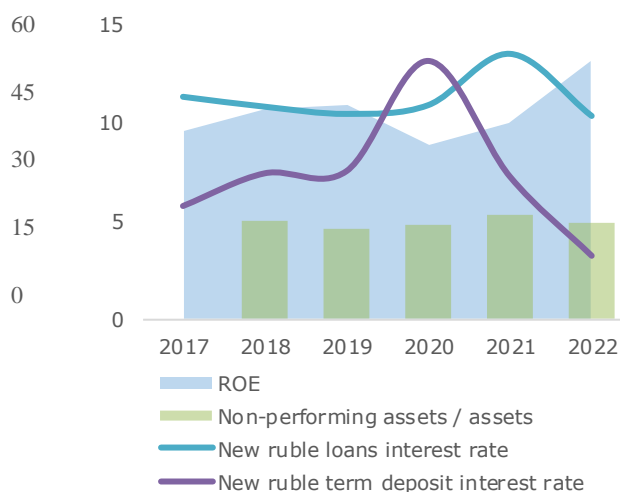
Support provided by the authorities and growth of banks' incomes contributed to some improvement in their financial condition and better financial soundness indicators. Against the background of an increase in banks' authorised capital funded by the budget and reinvested profits of previous years, the regulatory capital of banks grew by BYN 3.6 billion compared to the beginning of 2022. The capital adequacy ratio improved from 17.9% to 21.0%. The return on equity increased to 13.2% in 2022 (against 10.0% at end-2021), and the return on assets reached 2% (against 1.4% at end-2021). Banks' profitability grew owing to a 57.6% increase in profits, mainly due to higher interest margins, as well as growth of other incomes, including those associated with transactions in foreign currencies⁹. Due to the transfer of part of bank loans to the Asset Management Agency, the share of non-performing assets in assets exposed to credit risk decreased in 2022 to 4.9% against 5.3% at the beginning of the year (Figure 10).

Figure 9. Bank lending (in %, y-o-y)



Source: NBRB

Figure 10. Banking sector indicators (in %)



Source: NBRB

Medium-Term Outlook

Under the baseline scenario of the EFSD Project Unit, in the medium term, the Belarusian economy would continue to operate under the pressure of sanctions faced by the RB and the RF. However, the economy is expected to adjust to the changed conditions in some way, as well as gradually build new logistics channels and production ties, among other things, through the implementation of certain investment projects to manufacture import-substituting products to be delivered to the RF. The EFSD Project Unit expects that, as a result of gradual development of transport channels, exports of potash fertilizers would double in 2023. However, they would still remain below the levels registered until 2022. Under the terms of agreements to create a level playing field for Belarusian and Russian refineries¹⁰ through the transfer of a reverse excise duty to Belarusian oil refiners, as well as opening the Russian market for Belarusian petroleum products, the output of petroleum products is expected to increase by about a third in 2023–2025.

⁹ A likely source of profit was a greater spread for currency exchange transactions with Russian rubles.

¹⁰ Under the agreement on general principles of taxation in terms of indirect taxes, which sets forth, among other things, the entitlement of Belarusian refineries for a reverse excise duty.

In 2023, the real GDP growth rate is projected at 2.5%, which will be facilitated by a slight recovery in exports of potash fertilizers and petroleum products, as well as an increase in salaries and wages in the budget sector. The investment activity, however, would remain weak, even despite the implementation of certain import-substitution projects. Under the impact of persistent structural constraints, the real GDP growth in Belarus would slow down to about 0.8% in 2024 and 2025.

Monetary policy is expected to be based on the priority of achieving the inflation target. The persistence of a negative output gap and the expected relative stability of the exchange rate would contribute to a slowdown in inflation in 2023. By mid-2023, the annual inflation is likely to fall to 3–4%. In H2 2023, as wages and salaries increase, mainly in the budget sector, the disinflationary effect of domestic demand would weaken, and by end-2023, inflation is projected to reach 7% against the targeted range of 7–8%. At the same time, taking into account the expected persistence of the negative output gap and a slowdown in inflationary processes, the baseline scenario includes relatively soft monetary conditions maintained in 2023 with a gradual reduction of the refinancing rate by the NBRB. In the medium term (2024–2025), it is expected that the authorities would aim to ensure inflation deceleration to 5%.

In 2023, fiscal policy would support the economy through a raise of salaries and wages in the budget sector, with consolidation assumed for 2024 and 2025. The consolidated budget deficit is projected at a moderate level of 0.2% of GDP in 2023. One of important factors supporting the budget would be uncompensated revenues received by the budget (up to 2.3% of GDP in 2023), mainly through transfers from the RF. In 2024 and 2025, the EFSD projects a decrease in uncompensated revenues to 1% of GDP annually, which entails further revenues from the RF only in the form of the reverse excise duty on oil. The decrease in uncompensated revenues and limited sources of financing would call for gradual fiscal consolidation in the medium term. As a result, even with some expenditure cuts in 2024, the budget deficit may increase to 0.8% of GDP. However, further fiscal consolidation in 2025 would ensure a balanced budget.

A trade surplus, receipt of transfers from the RF budget, and the expected slowdown in the outflow of funds under the financial account would contribute to maintaining an external balance within the forecast period. The CA balance is expected to be positive at 4% of GDP in 2023, about 2.4% of GDP in 2024, and 2.3% of GDP in 2025, which would be facilitated by a continued trade surplus amid higher exports of fertilizers and petroleum products and restrained imports in the face of limited domestic demand, as well as transfers from the RF budget. In turn, the outflow of funds under the financial account is projected at 3.4% of GDP in 2023, as well as 3.5% of GDP in 2024, and 2.1% of GDP in 2025. Gradual repayment of debts of banks and enterprises in dollars and euros accumulated earlier, which would reduce the amount of payments in subsequent years, as well as partial refinancing of debts, would contribute to a slowdown in the outflow of funds under the financial account. In that environment, the gross reserves, although slightly down during the forecast period (to US \$7.6–7.8 billion or 2.0 months of imports), would remain above the minimum permissible level¹¹, among other things, due to the NBRB's purchases of foreign exchange on the domestic market. At the same time, the volume of net sales of foreign exchange by economic agents in the domestic foreign exchange market is projected to total US \$3.8 billion in 2023–2025.

The need to repay and service Government debt obligations would be a key factor of pressure on the fiscal accounts and the balance of payments.

¹¹ The Main Monetary Policy Guidelines of the Republic of Belarus provide for maintaining the GIR at a level of least US \$6 billion.

Government deposits in foreign currency, including those in Russian rubles, would continue to be a significant source of repayment and servicing of government debt in the face of limited options to mobilise new borrowings. It is assumed that obligations to repay Eurobonds and debts to creditors from “unfriendly” countries would be fulfilled in Belarusian rubels with funds credited to accounts with RB resident banks. However, as early as in 2024, the overall volume of MF RB deposits would be practically exhausted and would be insufficient for full and timely fulfilment of all obligations, thus creating a need for additional financing.

According to the EFSD Project Unit, the RB has sufficient internal reserves to finance the fiscal gap, without disturbing the macroeconomic balance, by issuing domestic government debt obligations. This assessment is based on the projected fairly high level of excess bank liquidity and net supply of foreign currency on the domestic market, which would enable the conversion of Belarusian rubels to foreign currency without creating pressure to further depreciate the Belarusian rubel.

Risks and Uncertainties of the Medium-Term Outlook

The most significant risks of the medium-term outlook include an expansion of the negative impact of sanctions, as well as deterioration of the economic situation in Russia. The list of companies and entities subject to sanctions may be expanded, and the impact of imposed restrictions may have more severe negative consequences, among other things due to stronger logistical difficulties in exporting key items and importing components for production, as well as limited access to sources of refinancing the external debt of the banking sector and other sectors.

An important factor of uncertainty is the ability of Belarusian enterprises and banks to adapt to the changed environment. The progress in redirecting traditional exports to new markets and expanding trade in new goods will largely depend on the pace of establishing trade logistics, as well as success in modernising Belarusian enterprises and developing new types of products. However, sanctions, including those associated with technological equipment and dual-use goods, will be an important constraint for this. In addition, the growing debt pressure on enterprises against the background of lower output may be a significant factor contributing to an increase in banks' non-performing assets. If realised, this risk may call for additional budget expenditures and/or domestic debt to support the banking sector.

If investors exercise their right to receive payments against debt obligations by withdrawing the BYN amounts placed by the MF RB in banks, there will be risks of capital outflows in the future. After investors gain access to their funds, a significant part of the funds will be converted into foreign currency and transferred to foreign accounts. At that point, the economy may face capital outflows, which will put pressure on the exchange rate and balance of payments. Low gross reserves would constrain the ability of the NBRB to support the exchange rate. Under such conditions, the risk of further depreciation of the Belarusian rubel increases, generating negative impacts on inflation, economic activity, budget revenues, as well as leading to higher financing needs.

The relatively high level of interest rates on the domestic market creates risks for budget financing and debt sustainability. Despite the expected reduction in interest rates against the background of decelerating inflation and excess BYN liquidity, the conditions for issuing government securities on the domestic market in volumes that would fully cover the financing needs may be assessed by the MF RB as unacceptable from the point of view of generating significant interest costs in the future.

Table 1. Belarus: Key macroeconomic indicators

	2022 Actual	2023 Forecast	2024 Forecast	2025 Forecast
<u>National accounts and prices (in %)</u>				
Real GDP growth	-4.7	2.5	0.8	0.8
CPI (December, y-o-y)	12.8	7.0	6.0	5.0
Real wage growth	-1.2	4.6	2.0	2.0
<u>Money and credit (end of period)</u>				
Broad money, percentage change	12.7	15.0	10.3	11.2
Policy interest rate	12.0	9.0	8.0	8.0
<u>Public finance (in % of GDP)</u>				
Budget balance ("-" deficit/"+" surplus)		-0.2	-0.8	0.0
<u>External sector (in % of GDP)</u>				
Current account	3.6	4.0	2.4	2.3
Foreign direct investment	1.9	2.0	1.9	1.8
Gross reserves, in months of imports of goods and services of the current year	2.2	2.3	2.0	2.0

Source: national agencies and EFSD estimates

Box: Impact of Demographic Trends on Long-Term Economic and Fiscal Stability in the Republic of Belarus

Belarus, like most middle-income countries, is in the process of the second demographic transition, which is characterised by a significant change in the institution of the family, the motivation to have children, and conscious regulation of the birth rate. Over the past 20 years, the birth rate in Belarus has not exceeded 1.7 births per woman of childbearing age, which is below the level that ensures simple reproduction. The natural decline in the population and outward migration have led to a decrease in the country's population (by 8% in 2021 compared to 1999) and its marked aging (the share of the population over working age has increased from 21.5% to 24.5%).

The dynamics of the working-age population in the 2000s contributed to economic growth – the contribution of the factor of labour to the annual real GDP growth was estimated at an average of about 0.3 p.p.¹²; in 2015–2019, it turned negative and was estimated at -0.6 p.p. Since 2020, the rate of reduction in the labour force has accelerated against the background of the COVID-19 pandemic and mounting internal and regional tension, generating further negative impacts on the GDP dynamics.

In the long run, the process of further depopulation would enhance the negative impact on economic growth rates and substantially increase the pressure on the budget. According to the UN forecast, a low birth rate would result in a reduction of the population of Belarus by 10% by 2050, and the working-age population by 22% compared to 2022. Experts estimate the cumulative negative contribution of the reduction of the working-age population to the GDP growth, all things being equal, at about 16% by 2050.

The unfavourable demographic situation generates pressure on the accounts of the Social Protection Fund as it is, which leads to a high level of insurance contribution rates. The dependency ratio, calculated as the ratio of the working age population to the non-working age population, was estimated by the EFSD Project Unit at about 0.65 in 2022. If the current trends persist, the dependency ratio would increase rapidly and is likely to reach about 0.85 by 2050, approaching 1 by the end of the 2050s. This would lead to a significant decrease in contributions to the Social Protection Fund and a drop in its revenues. According to EFSD estimates, in order to maintain the current average pension to average wages ratio, transfers from the national budget to cover the Fund's budget deficit would have to exceed 5% of GDP. The aging of the population will also cause an increase in budget spending on health care, which may become an additional factor of pressure on the country's fiscal position.

Under these conditions, the importance of improving the total factor productivity, which is the main tool for limiting the negative impact of the demographic situation, increases many times over. The EFSD proposes to consider reforms aimed at improving the flexibility of the labour market, enhancing the social protection of the unemployed, supporting private business and entrepreneurship, developing competition, and improving the quality of capital distribution as priority areas.

¹² Mironchik, N., Levikhina, A. How to Accelerate the Growth of the Belarusian Economy? (Bank Bulletin, Bank's Research No. 19, July 2020) (in Russian).