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# Can Loose Macroeconomic Policies Secure a ‘Growth Injection’ for Belarus?

After a relatively long period of macroeconomic stabilization, Belarus faces the threat of a purposeful deviation from it. However, today there is no room for a ‘growth injection’ by means of monetary policy. Moreover, Belarus still suffers from a problem of unanchored inflation expectations. This prevents monetary policy from being effective and powerful. So, unless inflation expectations have been anchored, any discussion about reshaping monetary policy and making it ‘pro-growth’ is meaningless.



## Policy Mix and Macroeconomic Landscape in Belarus

Since 2015, Belarus has considerably improved the quality of its macroeconomic policies. The country has fallen back upon a floating exchange rate, and feasible monetary and fiscal rules. This change followed a long history of voluntary expansionary policy mixes associated with numerous episodes of huge inflation, currency crises, etc.

Due to the new policy mix, the country has been displaying a movement towards macro stability in recent years. For instance, the external position is close to being balanced, the fiscal position has even become positive, while the inflation rate is at historical lows around 5%. For Belarus, these achievements are important, taking in mind a 'fresh memory' of price and financial instability. Hence, until recently there were no doubts in the feasibility of the commitments of Belarusian authorities to sound macroeconomic policies.

However, despite a relatively strong macroeconomic performance, the threat of a purposeful and at least temporary deviation from policy commitments seems to strengthen. What is important is that this time, popular simple explanations – e.g. political voluntarism (Belarus will have presidential elections in 2020), a naïve perception of economic policy mechanisms by authorities, etc. – are not sufficient for understanding the phenomenon. Rounds of loosening economic policies tend to be justified as 'lesser evils'. Exploring some rationality in such a justification requires more insight into the Belarusian macroeconomic landscape.

In recent years, the lack of productivity and output growth has become more evident: in 2015-2019 the average output growth rate has been around 0. The root of the problem is the deficit in productivity and growth (Kruk & Bornukova, 2014; Kruk, 2019), while the rules-based policy mix just uncovered it.

However, this direction of causation tends to be challenged by some policy-makers. In an 'archaic' manner, the policy mix is accused of blocking any pro-output policy discretion, even if there is a justification for it. For instance, an 'extra' need for a 'growth injection' may be justified by social challenges. Poor growth in Belarus results in a rather sensitive squeezing of relative levels of well-being in comparison to neighboring countries. Between 2012 and 2019, the well-being shrank from around 78% of the average level in 11 CEE countries down to about 63%. This intensified the labour outflow significantly, including for those employed in socially important industries, say, in healthcare. So, according to this view, the 'growth injection' is a lesser evil rather than systemic social threat.

A more advanced 'accusation' of the new policy mix assumes that it either causes a too restrictive stance of monetary policy with respect to output or that it ignores complicated transmission channels. For instance, one may argue that too much emphasis on price and financial stability can actually result in undermining them, given the huge debt burden of Belarusian firms. The quality of a considerable portion of the debts in Belarus tends to be sensitive to output growth rates. Hence, according to this argumentation, the monetary policy rule should be 'more pro-growth', reflecting the debt-growth-financial stability linkage inside it.

'Translating' this policy agenda to a research agenda results in two questions. First, is there room for a more expansionary monetary policy? Second, do financial instability risks require making the monetary policy rule 'more pro-growth'?

## The Monetary Policy Stance: Causality and Causes

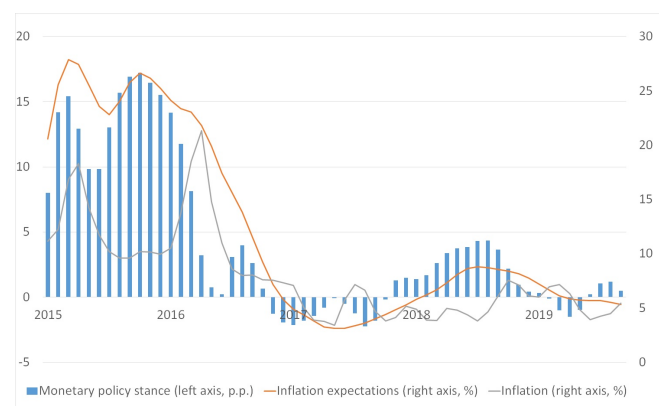
Monetary policy, as a rule, aims to be counter-cyclical, i.e. generate expansionary incentives during cyclical downturns, and vice versa. In this respect, its stance should be matched to the



estimate of the output gap. From this view, given dominating estimates of a near-zero output gap for 2019 in Belarus (National bank, 2019; Kruk, 2019), today's monetary policy should be roughly neutral. However, analyzing monetary policy stance together with the estimates of the output gap is not a univocal option, especially given doubts about the consistency of any estimate of the output gap (Coibion et al., 2017).

From this point of view, a direct measurement of the monetary policy stance – matching ex-post real interest rate vs. an ex-ante one – is a worthwhile alternative. If the ex-post real interest exceeds the ex-ante rate, it means that the interest rate policy by a central bank is restrictive, while an opposite situation witnesses its expansionary stance (e.g. Gottschalk, 2001). A methodology for identifying inflation expectations by Kruk (2016) allows detecting restrictive and expansionary stances as well. Moreover, doing it in this way allows simultaneously tracing the stance of actual and expected inflation, and study its possible impact on monetary policy (Figure 1).

*Figure 1. Monetary Policy Stance, Actual Inflation and Inflation Expectations in Belarus*



Note: Positive sign means restrictive stance of monetary policy, while negative sign means expansionary stance.

Source: Own elaboration according to methodology in Kruk (2016) and based on data from the National Bank of Belarus.

First, this diagnostic shows that the stance of the monetary policy today is roughly neutral, which conforms to the diagnosis based on matching with the output gap. In this respect, it means that there is no room for monetary policy softening today.

However, eventually the situation may change and a need for an expansionary monetary policy may indeed arise. Can the National Bank of Belarus unconditionally satisfy such demand? Second, and the more important conclusion, is that the National Bank cannot. Figure 1 also demonstrates that the monetary policy stance in Belarus is very sensitive to the stance of inflation expectations. From this view, the restrictive monetary policy, say in 2015-2016 and 2018, reflected shocks in inflation expectations. The National Bank had to take a mark-up in the expected inflation in respect to the actual one into account and to transform it to the mark-up of the interest rate. If the National Bank ignores such shocks and nevertheless softens monetary policy, it will undermine price stability due to a powerful transmission effect from expected inflation to the actual one. Moreover, a reverse linkage from actual inflation to the expected one is likely to result in a prolonged inflationary period, causing a so-called 'abnormal' stance of the monetary environment (Kruk, 2016).

So, a generalized policy diagnosis for today looks as follows. Monetary policy has reached a roughly neutral level due to a considerable reduction in inflation expectations. The latter, in turn, happened due to a prolonged period of a restrictive policy stance (in 2015-2016), which suppressed actual inflation by means of sacrificing output in a sense (the period of cyclical downturn could have been shorter without such limitations in monetary policy).

## Unanchored Expectations Bar a More 'Pro-Growth' Policy

A deeper cause of the limited room for monetary policies is unanchored inflation expectations. Statistical properties of the inflation expectations series (Kruk, 2019 and 2016), as well as the polls of households and firms by the National Bank, suggest that despite the reduction of the level of inflation expectations, the issue of it being unanchored is still on the agenda. In this respect,



expected inflation in Belarus tends to be sensitive to numerous kinds of actual and information shocks, e.g. domestic and global output dynamics, interest rate levels and spreads, exchange rates, financial stability issues, etc. Hence, unless expectations have been anchored, the monetary policy would still suffer from a lack of power. This means that anchoring inflation expectations is the core precondition for normalizing the monetary environment and the power of any monetary policy.

For the monetary rule, this means that it cannot become more 'pro-growth', keeping in mind the risks to financial stability. Otherwise, it can spur price destabilization, which may also trigger financial instability. Hence, the logic of a 'lesser evil' does not work. Indeed, there are risks to financial stability stemming from poor growth. But combating them through a more 'pro-growth' policy will cause price instability and financial instability stemming from that. But what is more important, the logic of a 'lesser evil' itself is doubtful with respect to monetary policy. Recognizing the linkage between monetary policy and financial stability does not mean that risks to the latter should be directly traced by the former. Financial stability issues can and should primarily be tackled through macroprudential tools.

## Conclusions

After a relatively long period of macroeconomic stabilization, Belarus faces some risk with respect to it. However, today's monetary policy stance is roughly neutral in Belarus. Hence, a 'growth injection' may result in inflation resurgence. Moreover, even today's near-neutral monetary policy stance is a considerable achievement, as the country still experiences the challenge of unanchored inflation expectations. This issue is a deep underlying problem, which keeps the monetary policy from being more effective and powerful. So, unless inflation expectations have been anchored, any discussion about reshaping it and making it 'pro-growth' is meaningless.

As for today's justifications for monetary policy softening – poor growth and financial instability risks – they hardly relate with the monetary policy agenda. The challenge of poor growth requires thinking in terms of productivity issues, while financial stability risks in terms of macroprudential tools first.

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