

weekly
e-bulletin

31.10.2017-06.11.2017 • No: 136



RECENT EXCHANGE RATE DEVELOPMENTS IN KAZAKHSTAN

In August 2015, the National Bank of Kazakhstan (NBK) adopted the inflation targeting monetary policy regime. Previously, the monetary authority used the fixed exchange rate policy with the national currency, the tenge, pegged to a multi-currency basket with weights 10%, 20% and 70% for the Russian ruble, euro, and the U.S. dollar, respectively. After the introduction of the inflation targeting policy, the NBK allowed the national currency to float freely, having retained the right to resort to currency interventions if the financial system faces threats of destabilization.

Kazakhstan had to introduce the fixed exchange rate policy in 2009 in order to respond to the negative impact of the global financial crisis. In 2008-2009, as a result of a sharp fall in commodity prices coupled with the liquidity crisis in emerging countries that led to the suspension of investments in developing countries, Kazakhstan's balance of payments seriously deteriorated. In order to save the foreign exchange reserves of the country and reduce a growing pressure on the national currency, in February 2009, the NBK devaluated the tenge by 22% from about 120 tenge per \$1 to 150 tenge per \$1. The NBK kept the exchange rate stable at about 150 tenge per \$1 until the beginning of 2014. In 2013, the U.S. Federal Reserve closed its Quantitative Easing Program, which had been one of the key sources of investment inflow to developing countries. Similar to 2009, reduced investment inflow had a negative effect on Kazakhstan's balance of payments, which in turn had a negative effect on the tenge. For instance, from 2013 to 2016, net capital outflow from Kazakhstan was more than \$42 billion, while net capital inflow from 2010 to 2012 was about \$45 billion. Therefore, in February 2014, the NBK again devalued the currency by about 19% from around 155 tenge per \$1 to 185 tenge per \$1 and set the fluctuation corridor for the exchange rate at six tenge from 182 tenge per \$1 to 188 tenge per \$1.

Despite the fact that the devaluation was highly expected, tenge's depreciation in 2014 caused discontent among the population, with people starting to convert savings into foreign currency. To prevent further dollarization, the NBK pledged to avoid another devaluation in the near term. However, in the second half of 2014 it became clear that due to some unfavorable external developments the NBK might need another devaluation. In March-April 2014, the United States and its western allies imposed sanctions on Russia because of the annexation of Crimea, which had a negative effect on the Russian economy and its currency.

Since Russia is one of the largest trading partners of Kazakhstan, the downward trend heavily affected Kazakhstan's economy, too. Moreover, in the second half of 2014, the global oil prices fell sharply, which, similar to 2009, adversely affected the national currency. In order not to lose its credibility, the NBK kept the exchange rate at about 180 tenge per \$1 until the mid-2015. However, the NBK's pledge to maintain the exchange rate was not sufficient for the population, and the share of deposits in foreign currency reached 67% by the end of June 2015, while in early 2014 the share of deposits in tenge was 62.6%.

It is important to note that the NBK spent significant foreign currency reserves to maintain the exchange rate. For example, according to NBK Chairman Daniyar Akishev, the bank spent \$22 billion in 2014 and \$17.7 billion in 2015 in order to keep the fixed exchange rate. The NBK did not specify the sources of spending for this purpose, but it is quite probable that the bank used assets from the National Fund of Kazakhstan and currency swaps that were introduced by the bank in 2014 to provide tenge liquidity to second tier banks. However, further maintenance of the fixed exchange rate meant that the NBK would have to continue using foreign exchange reserves, which totaled only \$29 billion as of the end of July 2015. This amount was enough to help maintain the tenge's rate for just a year and a half. Therefore, in mid-August 2015 the NBK finally decided to adopt the inflation targeting policy and let the national currency float freely. As soon as the NBK reneged on the fixed exchange rate, the tenge depreciated by about 35% from 185 tenge per \$1 to about 250 tenge per \$1 in a day. Moreover, by the end of September, the rate reached 270 tenge per \$1. This sharp depreciation showed that the tenge was too overvalued because of the NBK's unwillingness to devalue it earlier.

In an attempt to avoid panic and calm public fears, the NBK had to make interventions in the exchange market. According to the NBK, from mid-September until early October 2015 it spent about \$1.7 billion in terms of interventions. In November-December 2015, the NBK continued its interventions, but they were much smaller, totaling \$274 million. As a result of decrease in interventions, the tenge depreciated further from 279 tenge per \$1 to 331 tenge per \$1. Moreover, the tenge continued its depreciation in the beginning of 2016, reaching its all-time low of 383 tenge per \$1 on January 22, 2016. After reaching its lowest point, the tenge slowly started to appreciate, partly because

people who sought to gain benefits from the devaluation decided to fix their profits and partly because in February 2016 there was a deadline for the payment of annual income taxes for 2015, meaning that economic agents had to convert their savings from foreign currencies into the tenge to pay taxes. As a result, the tenge appreciated up to 333 tenge per \$1. This appreciation was a turning point for the tenge, showing that investing in foreign currencies does not automatically protect investors from losing money as the floating exchange rate may lead to a more expensive tenge. Thus, in order not to lose on the tenge's appreciation, the population has gradually opted to keep savings in the national currency as the tenge continues to strengthen.

In order to keep the tenge from appreciating too fast, the NBK had to buy foreign currency for the first time in two years. The NBK shows that in the first half of 2016 it was a net buyer of foreign currency and bought \$1.63 billion in the exchange market to prevent a rapid appreciation of the tenge. Since the situation was stabilized, the NBK did not intervene much in the foreign exchange market from the second half of 2016 through the first half of 2017. However, in June-September 2017, the bank made an intervention in the amount of \$240 million to prevent significant fluctuations in the market. It is worth mentioning that the stable situation with the tenge's exchange rate has had a positive effect on the share of deposits in the national currency, which increased to 50% in August 2017 from about 30% in the beginning of 2016.

In sum, the decision of the NBK to move to a free-floating currency was a measure that had a positive effect on the stability of the country's financial system. Despite worse expectations, it eventually increased the population's confidence in the tenge, which was previously weakened by the NBK's inconsistent policy. If the NBK continues its policy, it is quite possible that the share of deposits in foreign currency will decline further, and the exchange rate of the national currency will be less volatile and less susceptible to speculative sentiments. It is obvious that if external and internal factors, such as oil prices and expectations of domestic economic agents, remain stable the national currency will keep to gradually appreciate. It appears that the tenge's exchange rate has already hit the bottom, but it remains to be seen how strong the tenge could become in the longer term.

Politics, Foreign Affairs and Security

- According to the President of Kyrgyzstan's Office, President-elect Sooronbai Jeenbekov's inauguration is scheduled for November 24, 2017, at the Ala-Archa state residency. Under the law on presidential and parliamentary elections of Kyrgyzstan, the inauguration must be held within 30 calendar days from the date of the official publication of election results.
- During the trilateral summit of presidents of Azerbaijan, Iran and Russia held in Tehran, Ilham Aliyev, Hassan Rouhani and Vladimir Putin discussed mutual cooperation, especially in the fields of transit and energy. Regional issues, including security and terrorism, were also on the top of the agenda.
- During the Council of the Commonwealth of Independent States (CIS) Heads of Government held in Tashkent, the prime ministers of the member states signed a number of documents concerning issues of mutual trade and economic cooperation within the CIS free trade zone, development of oil and gas engineering, land reclamation and control over the customs value of goods.
- During his official visit to Dushanbe, President of Turkmenistan Gurbanguly Berdimuhamedov met with his Tajik counterpart Emomali Rahmon to exchange views on deepening cooperation in the humanitarian, scientific and cultural spheres and discuss regional and international issues.
- During his official visit to Tashkent, Director General of the Bureau for Eastern Europe and Eurasia of the Ministry of Foreign Affairs, Trade and Development of Canada Alison LeClaire met with Minister of Foreign Affairs of Uzbekistan Abdulaziz Kamilov to discuss prospects for developing bilateral relations in the political, economic, investment, cultural, humanitarian, and other spheres. The sides also considered interaction of the countries within the UN and other international institutions.
- During his official visit to Tashkent, Prime Minister of Russia Dmitry Medvedev met with Prime Minister of Uzbekistan Abdulla Aripov to discuss further prospects for developing cooperation in the military-technical, migration, and energy spheres. Following the talks, the parties signed a package of memorandums and agreements intended to develop cooperation in the oil-refining, banking, investment, and industrial spheres.
- According to the Ministry of Defense of Kazakhstan, the second joint military exercise 'Prabal Dostyk-2017'

of the Indian and Kazakhstani armed forces was launched in Bakloh in Himachal Pradesh. The 14-day joint exercise is aimed at enhancing military ties between the two countries and achieving interoperability between the two armies.

Economy, Finance and Energy

- According to Sergei Chemezov, CEO of the Russian state-owned company Rostec, the company's arms exporter Rosoboronexport sold weapons and military equipment worth \$140 billion over 17 years of its operation. It was noted that Rosoboronexport is actively interacting with more than 50 countries of the world.
- The World Bank's Board of Executive Directors approved the Heat Supply Improvement Project for Kyrgyzstan that will allow more than 200,000 people in the country to benefit from the improved efficiency and quality of heating during cold winter months. It was noted that the project will be financed by the combination of a \$23 million credit and a \$23 million grant.
- According to the Financial Market Supervisory Authority of Azerbaijan, in October 2017 liabilities of the country's banks to the Central Bank decreased to 570.8 million manats (\$335.6 million), or by almost three times, compared to early 2017. It was also noted that banks reduced their total liabilities by 21.6%, from 29.53 billion manats (\$17.39 billion) to 23.15 billion manats (\$13.63 billion), since the beginning of the year.
- According to the Government of Kyrgyzstan, the country's budget for 2017 was amended. The total amount of state budget expenditures for 2017 is estimated at 177.12 billion soms (\$2.5 billion), or 35.8% of GDP, which is 12.86 billion soms (\$185.9 million) more than the previously approved budget. The deficit of the state budget will amount to 21.06 billion soms (\$304.4 million), or 4.3% of GDP. The volume of state budget revenues, including public investment grants, is projected at 156.05 billion soms (\$2.2 billion), or 31.6% of GDP.
- According to Azerbaijan's state-owned energy company Azerenergy, in January-October 2017 the country generated 18.3 billion kilowatt hours of electricity, as compared to 18.4 billion kilowatt hours in the same period of 2016. It was also noted that more than 1.73 billion kilowatt hours of electricity were generated by Azerenergy's power plants in October 2017.
- According to the Committee on Statistics of Kazakhstan's Ministry of National Economy, in October 2017 the inflation rate increased to 1.2% compared to 0.3% in September

2017. In the past month, prices for food and non-food products rose by 1.3% and 1.9%, respectively, while prices for paid services increased by 0.3%.

Society and Culture

- During his official visit to Tashkent, Prime Minister of Armenia Karen Karapetyan met with his Uzbek counterpart Abdulla Aripov to discuss issues related to the opening of direct flights between Tashkent and Yerevan. The parties also discussed possibilities of developing cooperation in the field of tourism and noted the importance of setting up an intergovernmental commission on economic cooperation.
- According to the Government of Japan, well-known Kazakh poet, politician and anti-nuclear activist, President of the Nevada-Semipalatinsk Anti-nuclear International Movement Olzhas Suleimenov will be awarded the Order of the Rising Sun. The order is awarded to foreign individuals who have contributed to the friendship between Japan and other states and made major breakthroughs in other fields.
- According to the China Aerospace Science and Technology Corporation, the country plans to launch its reusable spacecraft in 2020. It was noted that unlike traditional one-off spacecraft, the new spacecraft will fly into the sky like an aircraft. The spacecraft can transport people or payload into the orbit and return to Earth.
- According to the decree of President of Kyrgyzstan Almazbek Atambayev, the Presidential Fund for Social Protection and Support will allocate financial support to the Bishkek Mayor's Office for the renovation of the Friendship of Peoples Monument and the adjoining park territory near the Ala-Too Square. The monument symbolizes the friendship of the peoples of Kyrgyzstan and Russia.
- According to the Government of Uzbekistan, the country plans to open an embassy in Minsk. It was noted that Uzbekistan would appoint an ambassador to Belarus in the near future.
- During his official visit to Tashkent, United Nation's Under-Secretary-General and Executive Director of the United Nations Office on Drugs and Crime Yury Fedotov met with President of Uzbekistan Shavkat Mirziyoyev to discuss further strengthening of bilateral cooperation and adoption of coordinated measures to combat drug trafficking, crime and terrorism.