JUSAN ANALYTICS

Monetary conditions

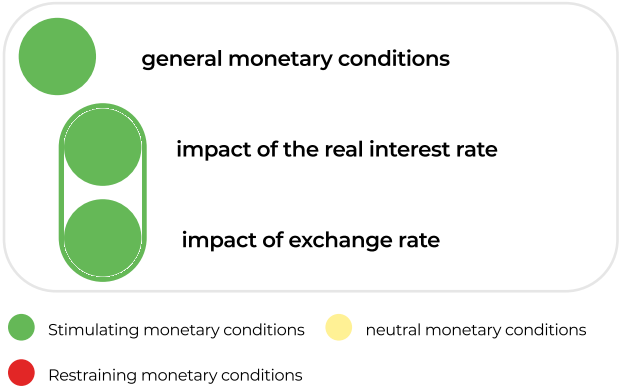
August 2022

Periodic research

October 2022

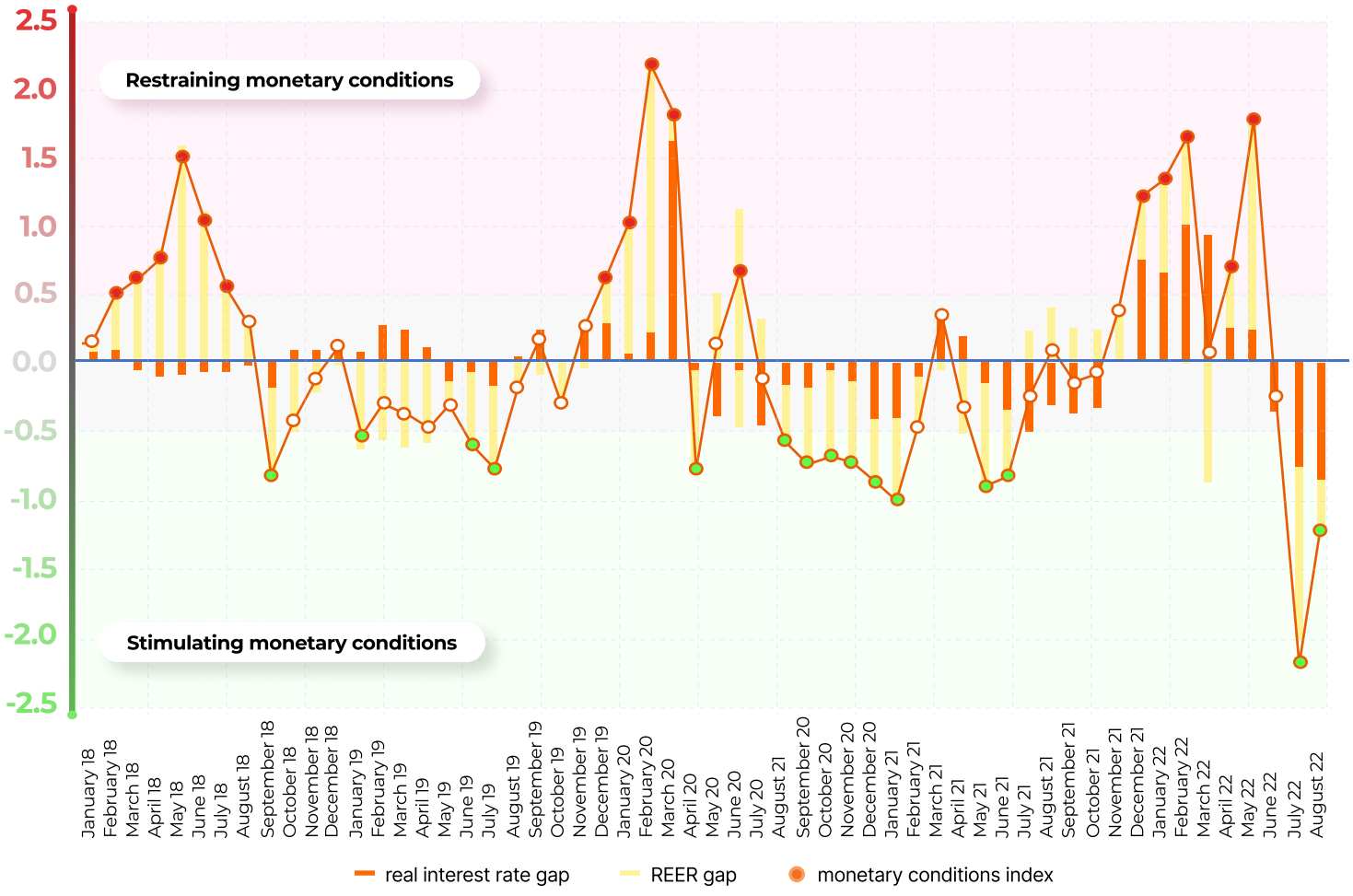
Interpretation of results

According to the results of August 2022, the dynamics of the Real Monetary Conditions Index (RMCI) signal the **preservation of stimulating conditions in the economy, contributing to the growth of aggregate demand and business activity.**



This, for the most part, is facilitated by an even greater transition of the real interest rate to the negative zone (-2.26% at the end of August against -1.91% in July). There was a reduction in the previously observed record negative gap by more than 3 times by the real effective exchange rate of the tenge in August, this is due to the tenge strengthening against the ruble and the euro in nominal terms, as well as an increase in the inflation rate in the European Union. At the same time, the current gap in the real effective exchange rate of tenge still has a stimulating effect on trade activity in the country.

Dynamics of Monetary Conditions Index



[1]From an analytical point of view, not the absolute value of RMCI itself is important, but its dynamics. When the Index is in a negative zone, we can talk about a period stimulating monetary conditions, in a positive one – about a restraining one. If the RMCI value ranges from -1 to 1, we regard this as neutral monetary conditions.

Interpretation of results

The negative gap in the real effective exchange rate of tenge contributes to maintaining favourable conditions for export-oriented domestic producers. On the other hand, the relatively weak tenge is the reason for the hike in imported goods, which occupy a significant share in the structure of total consumption, thereby contributing to the strengthening of inflationary pressure in the economy. Further price increases, all other things being equal, will widen the gap in the real interest rate. Accordingly, the current revenue from export activities has a stronger stimulating effect on the subsequent growth of money supply and aggregate demand in the economy.

Also, the negative gap in the real interest rate contributes to the relative cheapness of borrowed funds, which supports a high level of unproductive lending and the corresponding excess demand in the economy. Despite the hikes in the country, such a credit incentive does not allow consumption to reduce due to the adjustment of the economy to external price shocks. Thus, the current inflationary conditions and a lower premium to the base rate create prerequisites for an increase in demand for lending resources and force banks to increase, first of all, high-yield retail lending to maintain their marginality.

As a result of the interaction of these two factors, stimulating monetary conditions contributing to maintaining high inflationary pressure are formed. At the same time, it is necessary to take into account the strong imbalances in the structure of the economy of Kazakhstan, and such monetary conditions reinforce the existing structural issues to a greater extent than they lead to growth.

Calculation methodology

Real Monetary Condition Index (RMCI) is used to assess and analyze the monetary policy conditions and subsequent monetary decision-making. The real interest rate (the difference between TONIA and the actual level of price growth) and the real effective exchange rate of tenge (REER) are used in the calculation to assess monetary conditions.

Two types of rates can reinforce or compensate each other, the simultaneous increase in the interest rate and the exchange rate tightens monetary conditions. On the other hand, if an increase in the interest rate is accompanied by a depreciation of the tenge, then the monetary conditions will either remain unchanged or go into stimulating ones.

In the case of Kazakhstan, which is characterized as a small open economy with low diversification and a weak interest rate channel, the ratio (1:3) most often used in calculating RMCI is not suitable, so we considered that the ratio of 1:1 would be optimal.

The equilibrium values of the real interest rate and the real effective exchange rate were determined using the Hodrick-Prescott filter.

Индекс монетарных условий рассчитывается по формуле:

where, $R_t - R_*$ - is real interest rate gap
$e_t - e_*$ - is real effective exchange rate gap
Θ_r – "is weight reflecting the effect of the interest rate on aggregate demand"
Θ_e – "is weight reflecting the effect of the exchange rate on aggregate demand"
$\Theta_R + \Theta_e = 1$

- The weighting coefficients reflect the effect of changes in the interest rate and the exchange rate on aggregate demand. According to international practice, their ratio is selected depending on the specifics and development of the economy. In developed countries, a 1:3 $(\Theta_e=0.25, \Theta_R=0.75)$ ratio of weights is usually used, this reflects the high development of financial markets, a strong interest rate channel of the monetary policy transmission mechanism and the ability to absorb external shocks through the exchange rate easily.

- And in developing countries, the ratio can vary from 1:1 to 1:4 $(\Theta_e=0.2., \Theta_R=0.8)$ and is selected by each country separately.

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