

# Monetary conditions

May 2023

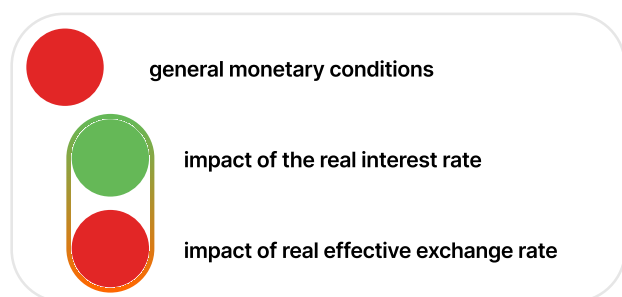
## Interpretation of results

According to RMCI dynamics, **there is a further monetary rigidity strengthening in May 2023.** The Index components have a unidirectional effect on prices, while the main contribution to the monetary conditions tightening is made by the exchange rate component. **According to the results of May 2023, both components of the RMCI index began to deviate more strongly from their equilibrium value.**

Despite the increasing transition of the real interest rate to the zone of positive values, provided by the weakening of price pressure while maintaining the NBK base rate at 16.75%, it has a weak deterrent effect on household consumption behaviour.

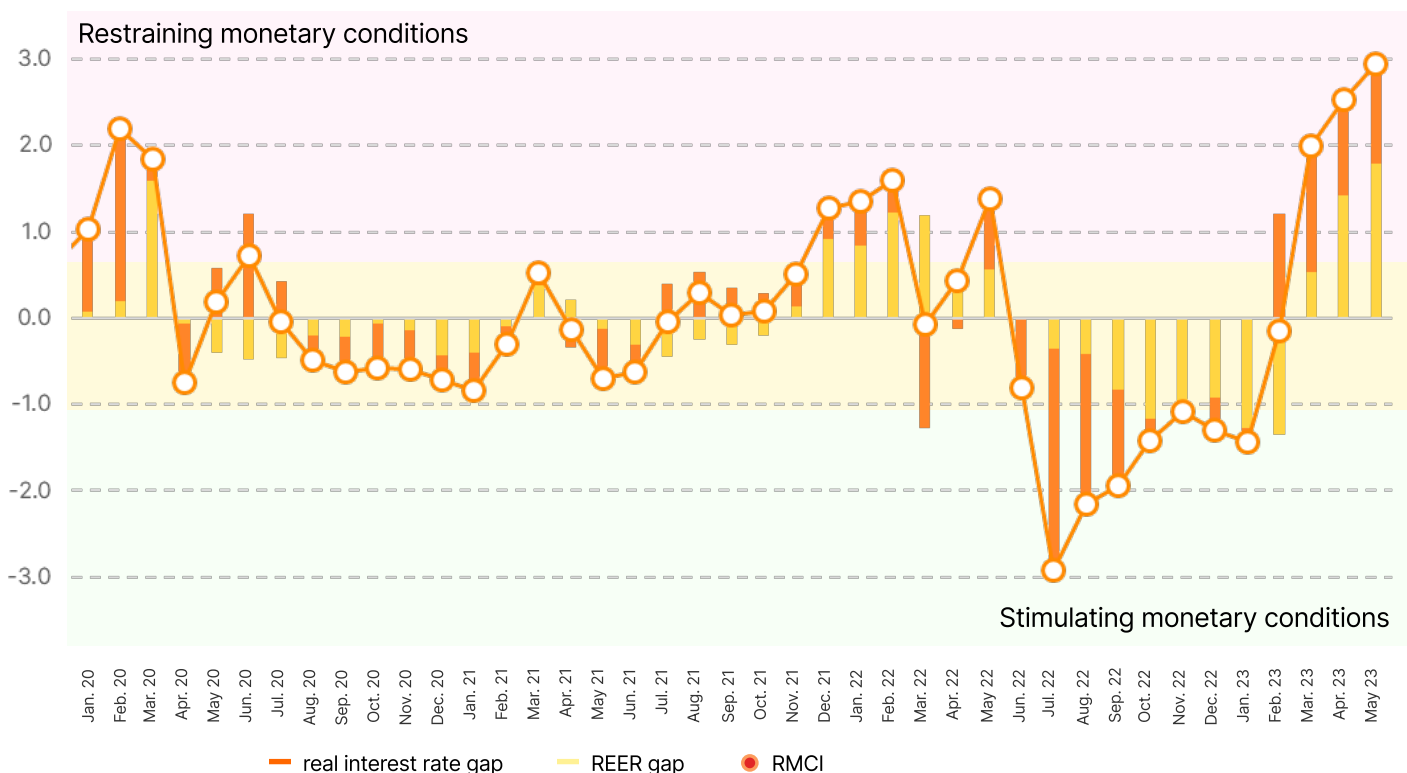
Firstly, the household decisions to save or spend come from their inflation expectations, which by the end of May 2023 were higher than the actual dynamics of price growth (17 vs. 15.9) and reflect the intuitive expectations of economic agents of further inflation growth due to the influence of price conjuncture in the housing and fuel markets. Secondly, the availability of consumer credit, as well as active fiscal leverage increases incentives to keep consumer demand excessive, which continues to create an imbalance in market forces.

The continued expansion of the positive gap in the real effective exchange rate of tenge, provided by a high base rate leads to an increase in the restraining effect of monetary conditions on the import component of prices. Thus, **the main influence of monetary conditions is mostly expressed in the control of the external component of consumer inflation. While measures aimed at limiting domestic price pressure do not work due to the inconsistency of macroeconomic policy measures and the weakness of the percentage channel of the monetary policy transmission mechanism.**



- stimulating monetary conditions
- neutral monetary conditions
- restraining monetary conditions

## Dynamics of Monetary Conditions Index



<sup>1</sup> 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.

## 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.

**RMCI is calculated by the following formula:**

$$RMCI = \theta_R (R_t - R_*) + \theta_e (e_t - e_*)$$

where,  $R_t - R_*$  - is real interest rate gap

$e_t - e_*$  - is real effective exchange rate gap

$\theta_R$  - "is weight reflecting the effect of the interest rate on aggregate demand"

$\theta_e$  - "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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