

Monetary conditions

September 2022

Interpretation of results

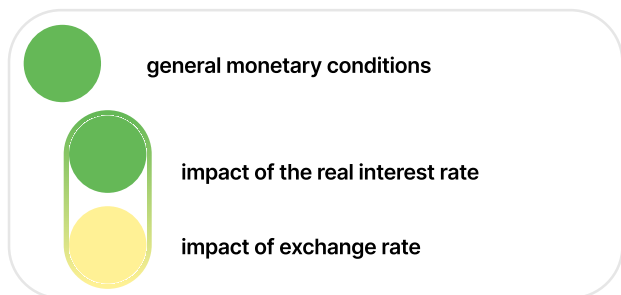
After a sharp reversal in the RMCI dynamics observed in the middle of summer this year, monetary conditions are gradually returning to the neutral zone.

According to the results of September, **the dynamics of the Real Monetary Conditions Index1 (RMCI) still correspond to the stimulating conditions, but its value came close to the neutral zone.**

Neutral conditions eliminate the stimulating effect on the short-term growth of several sectors of the economy, allowing further changes to reflect the real balance of factors to a greater extent.

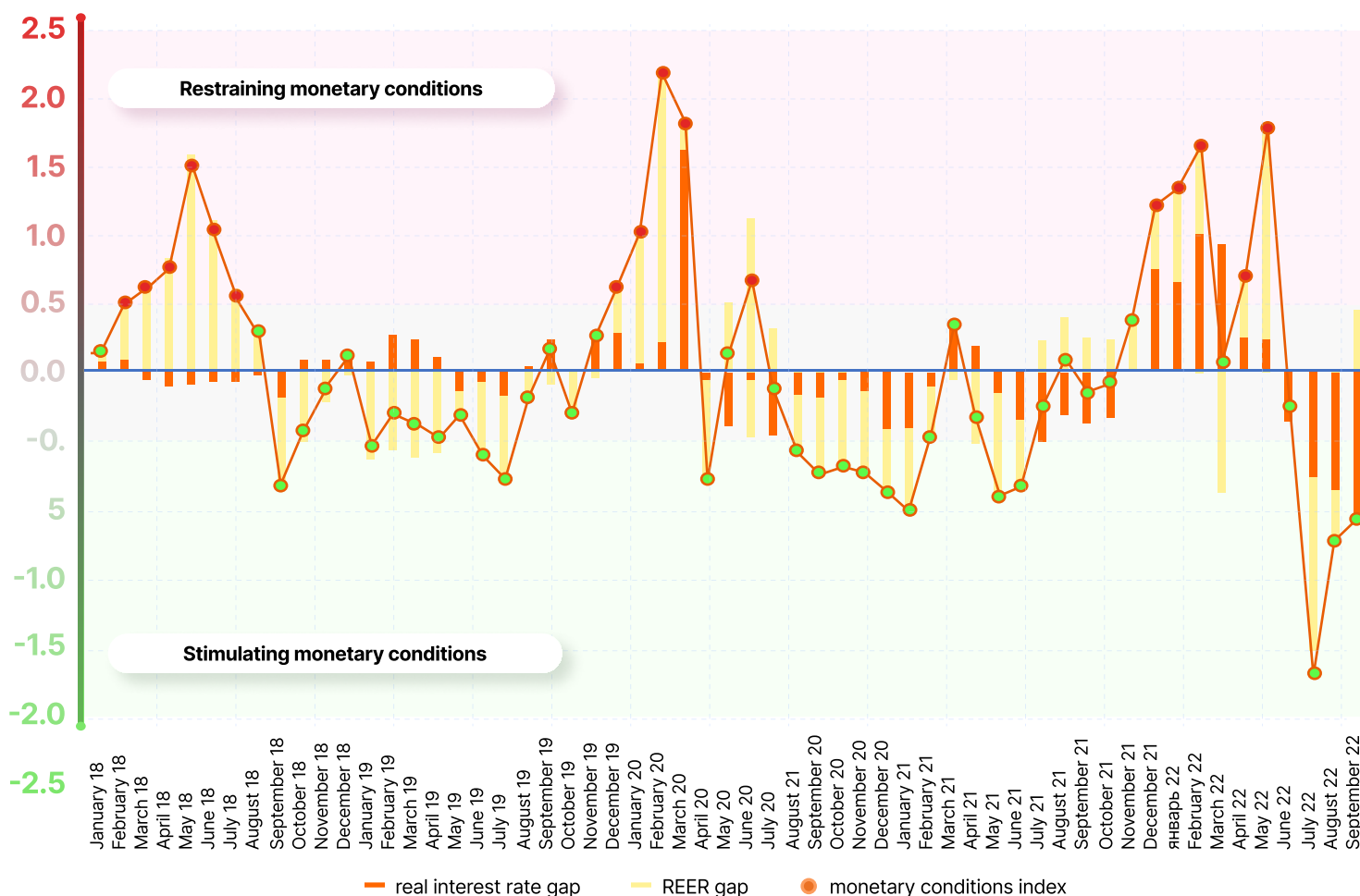
The shift of monetary conditions closer to neutral ones was ensured by a positive gap in the real effective exchange rate of tenge. In general, the deviation of the REOC from the equilibrium value is insignificant, and this indicates its compliance with the fundamental level.

Monetary conditions are still stimulated by the aggregated effect of the real interest rate on the RMCI dynamics. The observed gap stepping up between the real interest rate and its potential value is explained by the lack of reaction in the form of countering overheating in consumer demand in response to the increase in pro-inflationary processes in the economy.



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

Dynamics of Monetary Conditions Index



¹From 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 observed strengthening (growth) of the REOC by 2.5% to 74.5 by the end of September means that Kazakhstan's price competitiveness in foreign markets has somewhat decreased: export goods have become more expensive, and import goods, on the contrary, are cheaper.

However, the strengthening of the REOC should not negatively affect the volume of Kazakhstan's export earnings, since the price of oil remains quite high due to the artificial deficit created by OPEC+ and the seasonal increase in demand for energy resources. The simultaneous reduction in the cost of imported products has a disinflationary and slowing effect on the domestic growth of consumer prices, as well as creating more incentives for purchases abroad and bridling the desire to meet domestic demand at the expense of domestic production.

The gap in the real interest rate has increased by 2 times. Such a multidirectional impact of the RMCI component, together with accelerating inflation, creates incentives for further growth in consumer lending and imported goods demand. This worsens the effectiveness of anti-inflationary measures and thus leads to the formation of prolonged high prices in the economy of Kazakhstan. The long-term existence of the economy in conditions of abnormally high inflationary pressure and unpredictability of further inflation dynamics carries risks for its prospects.

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

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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