



TRANSITION TO THE FLOATING EXCHANGE RATE SYSTEM IN KAZAKHSTAN

As a result of low oil prices in the world markets, sanctions against Russia, depreciation of Russian ruble and devaluation in China, Kazakhstan has had to accept the floating exchange rate regime and to start implementation of a new monetary policy since August 20, 2015.

Kazakhstan faced a low growth rate and a considerably high inflation rate in 2014. In 2015 real GDP growth rate reduced from 6% (which is the average of the last 5 years) to 1.5% due to reduced domestic demand (6% in 2013 and 4.3% in 2014). Assuming that the oil price is \$53, the growth rate is expected to be 1.3% by the end of 2015. Actually, the low growth rate is a result of the devaluation of tenge in February 2014 and the oil price shock in the second half of 2014. Private consumption expenditures have been especially negatively affected by the negative wealth effect after the devaluation, constraints for borrowing provisions for consumers and delayed effect of low rate of increase in real wages in 2013. Besides, after the devaluation of 2014 as a result of high import prices, inflation rate increased from 4.5% (measured as CPI) in January 2014 to 7.4% in December 2014.

High reductions in oil prices since the second half of 2014 have reduced both budget and export revenues in Kazakhstan because oil products constitute a significant amount of total foreign revenue and approximately 40% of the GDP in Kazakhstan. According to the estimates by Moody's, the budget deficit is expected to be 3%. Besides, reductions in China's and Russia's demand for Kazakh crude oil, iron ore and metal products have caused reductions in Kazakhstan's export revenues. These problems have caused pressure on the exchange rate.

It is important to point out that reduction in oil prices due to cyclical contraction in Russian economy along with rapid depreciation in ruble have caused a serious pressure on tenge. Tenge has been appreciating since February 2014 (1 ruble=4.92 tenge). It appreciated by 71% in January 2015 and by 33% in May 2015. Depreciation of ruble has helped Russian goods to get cheaper and to increase exports and to reduce imports of Russia. Despite this pressure on tenge, Kazakhstan tried to stabilize exchange rates and keep the ex-

change rate in the corridor. As known, Kazakhstan and Russia have been sharing a 4250 miles border and Russia is one of the most important trade partners of Kazakhstan in the Eurasian Economic Union (EEU) and also is an important market for Kazakh goods. On the other hand, Russia has been exporting 70% of consumption goods in Kazakhstan. During this period, the price of Kazakh export goods have been nearly doubled and Kazakhstan's competition power has significantly reduced. Distinct differences in prices in Russian-Kazakh borders have caused trading in Russia more attractive for many Kazakh citizens. Many national Kazakh firms have been negatively affected by these circumstances.

Under these circumstances, the Central Bank of Kazakhstan (CBK) tried to keep exchange rates under control for a long time. In other words, the CBK tried to keep tenge-dollar rate in 1 dollar = 185 tenge (+3 tenge -15 tenge) corridor but had to extend this corridor by (170-198) in July 15, 2015. In order to continue to implement the fixed exchange rate regime, the CBK used exchange reserves of 28 billion dollars and implemented a strict monetary policy in the last 2 years.

However, low oil prices and depreciation of ruble have increased expectations for devaluation. Many Kazakh citizens have preferred to convert their savings to foreign exchange due to possible devaluation. In a sense, 'they have bought the expectation of devaluation'. Currently, only dollar has provided the classical functions of money (unit of account function, medium of exchange function and store of value function). Therefore, a dollarization process has partially been relevant in the Kazakh economy. Only one third of household bank accounts being in terms of tenge in December 2014 is an example of this situation. This amount was not sufficient for banks to continue to supply credits in tenge because approximately 70% of all bank credits were in terms of tenge at the end of 2014.

The main purpose of the control mechanism of Kazakh financial system in 2015 is to strengthen the role of national currency in the economy and with this purpose, to increase the lending possibilities of the banks in terms of tenge and to motivate the banking sector again. This purpose

can be achieved by reducing the troubled assets of banks.

It is known that, when countries want to adjust their competition powers, they can prefer to use exchange rate as a tool of economic policy. Besides, sometimes they have to make exchange rate adjustments in order to stabilize their deteriorated foreign balances and reduced exchange reserves. After China's devaluation (another important trade partner of Kazakhstan), Kazakhstan had to take measures in order to compensate for the reduction in its competition power and not to use exchange and gold reserves. The Kazakh Government and the CBK have started to implement a new monetary policy proposing a transition to the floating exchange rate regime since August 20, 2015. In this sense, the CBK will implement inflation targeting policy instead of exchange rate targeting policy and can intervene in the financial markets to ensure financial stability and price stability. Thus, Kazakhstan will implement a policy compatible with the policy of Russia who has accepted the floating exchange rate regime and has been implementing the inflation targeting policy but has been intervening in the financial markets when necessary since last year.

Given the structure of foreign trade of Kazakhstan, the cyclical situation of the world economy and the Russian economy will be contemplated because ruble continues to depreciate. Despite the floating exchange rate regime, measures against the depreciation of ruble should be continued because the depreciation of ruble has been leading to negative effects of 'beggar thy neighbor policy'. Clause 29 of the EEU indicates that member countries can implement temporary import restrictions, if the Union causes risks for economic security of the member countries. The content and timing of these restrictions should be determined regarding Kazakhstan's trade balance carefully.

Finally, it should be emphasized that the current crisis will probably move Kazakhstan to redefine its priorities and to implement substantial reforms. Low oil prices have been inevitably putting pressure on tenge to depreciate. However, these costs should be balanced with reforms that will help Kazakhstan to have more industrialized and less oil-dependent economy.

Politics, Foreign Affairs and Security

- According to the report of the Belarusian Central Election Commission, the current President of Belarus, Alexander Lukashenko, Nikolay Ulakhovich, Sergei Haidukovich and Tatiana Korotkevich were officially nominated as candidates for presidency after more than 100,000 signatures were submitted for their support. The Presidential elections in Belarus will take place in October 11, 2015.
- The President of Ukraine, Petro Poroshenko, has signed a law on amendments to Ukrainian legislation on the organization and holding of the first elections to local councils and of the heads of local self-governments in October 2015.
- The Defense Ministry of Azerbaijan announced that the joint tactical drills of the air forces of Azerbaijan and Turkey, dubbed "TurAz Qartali 2015" would continue until September 18. As part of the bilateral military cooperation plan, the drills are focused on the development of cooperation in the military-technical and military educational areas.
- The anti-terror mission against a rebel general, Abdulkhalim Nazarzoda, was introduced in Tajikistan due to the armed attack of two defense facilities in the town of Vakhdat, just 10 km east of the capital city of Dushanbe.
- The 8th meeting of the Kazakh-Turkish commission on cooperation in the field of defense industry was held in Astana. Representatives of the Ministries of Defense of Kazakhstan and Turkey discussed the development of cooperation in the field of automated control systems, joint modernization of armament, avionics, helicopters, domestic production of arms and military equipment.
- The spokesperson of the Chinese Defense Ministry, Yang Yujun, announced that China would complete the reduction of its military personnel by 300,000 by 2017. The personnel cuts will primarily affect units armed with outdated weaponry and administrative staff.

Economy, Finance and Energy

- KazTransGas, the national operator of the natural gas sector in Kazakhstan, started the first phase of

exploration of the coalbed methane in the Karaganda coal basin. KazTransGas is planning to drill seven wells. The first exploration phase would be finished in 2016.

- Russian national natural gas operator, Gazprom, increased the export of natural gas to Europe and Turkey by 22% in August 2015, comparing to the same period in 2014, from 11.13 to 13.6 billion cubic meters.
- Iranian production of oil climbed by 50,000 barrels a day to 2.9 million in August 2015 and reached the highest level during the last three years.
- During the official visit of the President of Kyrgyzstan, Almazbek Atambayev, to Iran, the Kyrgyz leader and his Iranian counterpart, Hassan Rouhani, agreed to cooperate in construction of large hydro power plants in Kyrgyzstan. The parties also discussed implementation of the China-Kyrgyzstan-Tajikistan-Afghanistan-Iran railroad project.
- During the visit of President of Tajikistan, Emomali Rakhmon, to China, the Central Bank of Tajikistan has signed a currency swap agreement worth about 3.2 billion yuan (\$500 million) with the Central Bank of China. The document will be valid for 3 years and can be extended upon mutual agreement.
- During the state visit of the President of Kazakhstan, Nursultan Nazarbayev, to China, the Kazakh leader held bilateral meetings with Chinese President Xi Jinping. Nazarbayev and Xi signed the Joint Declaration on a new stage of comprehensive strategic cooperation, and witnessed the signing of 11 bilateral intergovernmental and commercial agreements. The total cost of the 45 joint projects approved during the three-day visit could reach \$23 billion.
- During the state visit of the President of Turkmenistan, Gurbanguly Berdimuhamedov, to Afghanistan, the Ministry of Finance of Turkmenistan and the Financial Supervision Department of Afghanistan signed a Memorandum of Understanding (MoU) on cooperation in the exchange of financial data, on further development of cooperation in the energy sector, on cooperation in the field of sport, the agreement on cooperation in science and technology.

- During the official visit of the President of Russia, Vladimir Putin, to China, the leaders of both countries signed a package of bilateral documents. In addition, Russian national natural gas operator, Gazprom, and the China National Petroleum Corporation (CNPC) signed a MoU on natural gas supplies from Russia to China and construction of a pipeline to the Far East. Under the MoU, Gazprom and CNPC will set up a joint working group to conduct research on the gas supply project, including terms of delivery and a gas delivery point.
- During the visit of the President of Kyrgyzstan, Almazbek Atambayev, to China, the parties signed a cooperation program for the period from 2015 until 2025, including a cross-border cooperation program for the period of 2015-2020 and a 350 million yuan grant agreement for rehabilitation of the road network.
- The Russian Ministry of Finance stated that Russia's Reserve Fund grew by 9.2% and totaled 4.7 trillion rubles (\$69.4 billion) and the National Welfare Fund grew by 11.5% to 4.904 trillion rubles (\$72.5 billion) in August 2015.

Society and Culture

- About 100 people were wounded in the clashes and as a result of the grenade explosion outside the building of the Ukrainian parliament. Over 3,000 opponents of amendments to the Ukrainian Constitution took part in the clashes with police.
- The military parade, which marked the 70th anniversary of China's victory in the War of Resistance against Japan and the 70th anniversary of the end of World War II, was held in Beijing. Leaders and high-ranking officials from almost 50 countries took part in this celebration.
- According to the Kazkosmos, the Kazakh cosmonaut Aydin Aimbetov launched a research program of Kazakhstan to the International Space Station (ISS). Aydin Aimbetov's flight to the ISS would last 10 days, namely, from September 2 to September 12, 2015. He is the third Kazakh astronaut in history, and the third member of the crew of a spaceship Soyuz TMA-18M.