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TRANSMISSION MECHANISM OF MONETARY POLICY AND RESPONSE TO OUTSIDE SHOCKS IN 2020 BY NATIONAL BANK OF THE REPUBLIC OF KAZAKHSTAN

Abstract

The article examines the features and current state of monetary policy and transmission mechanism of the National Bank of Kazakhstan. The transmission mechanism is not a tool to achieve the goals set for the development of the modern economy. This mechanism is a set of interactions in economic processes through which the results of decisions or transactions in the framework of monetary policy affect the economy. In this regard, the article describes the level of inflation and its impact on the level of prices for goods and services. The situation with the use of the consumer price index to calculate inflation, calculated on the basis of the analysis of prices in the portfolio of consumer goods and services of the Ministry of National Economy of the Republic of Kazakhstan, is analyzed in detail. Macroeconomic and microeconomic factors, reflecting the viable direction of the monetary policy of the Republic of Kazakhstan, affect the level of the consumer price index. To make decisions, the NBRK conducts research to determine inflation forecasts. Inflationary expectations make it possible to assess the possible impact on the economy. In this context, the article states that the NBRK's inflation target will be achieved through the following channels (base rate, exchange rate and money supply). The conclusion is based on the fact that, given the global pandemic around the world, one can see the NBRK's expansionary monetary policy and decisions to lower the base rate, increase the money supply and stabilize the currency.

Key words: transmission mechanism, monetary policy, finance, inflation, pandemic, currency, macroeconomics, microeconomics.

11th of November 2019 President of Republic of Kazakhstan (hereinafter – RK) Tokaev K. signed a decree on reorganization of National Bank of Republic of Kazakhstan (hereinafter – NBRK) by separating the divisions responsible for regulation of capital markets and banks. The new governing body is called the Agency of the RK for Regulation and Development of Financial Market (hereinafter – ARDFM). Consequently, NBRK left with so called «standard» central bank responsibilities of management of monetary policy of RK with priorities on controlling base rate, exchange rate and money supply. Most of financial market participants positively reacted to such changes and noted that financial market development indeed moved forward [1]. Such view could arise, due to previous inefficiencies in the work of NBRK. Being that the central bank had wide range of responsibilities, granting an institute a lot of power, which led to high bureaucracy and consequently to slow decision making and reaction to market turbulences. Since the «new form» of National Bank started its operations in 2020, the year with many outside shocks, which required high involvement from NBRK to control price stability, in this paper the actions of NBRK and effectiveness its transmission mechanism was previewed and analyzed.

The NBRK is targeting the inflation rate. The inflation rate indicates the price level for goods and services. NBRK uses Consumer Price Index (CPI) to formulate inflation, which is calculated through the analysis of prices in the basket of consumer goods and services by the Ministry of National

Economy of Republic of Kazakhstan. Many macroeconomic and microeconomic factors affect the level of CPI, which makes this indicator a viable benchmark for the monetary policy of Republic of Kazakhstan. In decision making purposes NBRK also conducts surveys to find out expectations on the inflation. The inflationary expectations help to estimate a possible effect on the economy.

Targeted inflation rate of the NBRK is being achieved through three transmission channels: base rate, exchange rate and money supply. Each of the channels have different amount of impact on the ending goal. According to the study made in 2018 the most effective transmission mechanism that highly affects the prices is the exchange rate channel [2].

The main instruments to influence transmission channels used by NBRK are in-line with international practice, which include open market operations, operations with permanent access and establishment of minimal reserve requirements for banks.

Table 1 – The main instruments of influence on the transmission channels used by the NBRK

Purpose	Type of Instrument	Instrument	Collateral	Frequency	Provision / withdrawal duration
liquidity provision	permanent access operations	KASE currency swap	USD	upon request from commercial banks	1 day
		KASE Reverse Repo	government bonds	upon request from commercial banks	1 day
	open market operations	NBK auction for the purchase of securities with the reverse sale	Lombard List	as needed	7 days
liquidity withdrawal		NBK Notes Auction	–	in accordance with the schedule of issuance of notes	28, 91, 182, 364 days
		NBK Deposit Auction	–	daily	7 days
	permanent access operations		KASE currency swap	USD	upon request from commercial banks
		KASE Direct Repo	government bonds	upon request from commercial banks	1 day
		NBK Deposits	no collateral	upon request from commercial banks	1 day

Even though, the studies show that exchange rate is having highest impact on overall prices, the base rate is the key component of monetary policy management. National Bank ensures the mid-term price stability by influencing the short-term interbank money market rate through determination of the level of the base rate and the corridor. Theoretically the transmission mechanism of base rate is as shown in a Figure 1 (p. 181).

The exact influence of base rate decisions to the economy is hard to connect. However, theoretically the Figure 1 illustrates the decision making flow, that ends up with price development.

The outside shocks are the shocks outside the control of NBRK, but can impact the economy thus the financial market and price-setting. This can include changes in fiscal policy, changes in global economy, changes in commodity prices and trade.

The base rate directly influences money market rates and market expectations on future rates and inflation. Consequently, base rate indirectly affects the money lending, deposits and asset prices. In the third line, base rate affects the supply and demand in goods and labor markets, which helps to determine wages and prices. Money market rates also affect exchange rate, which directly interferes with imported goods prices [2].

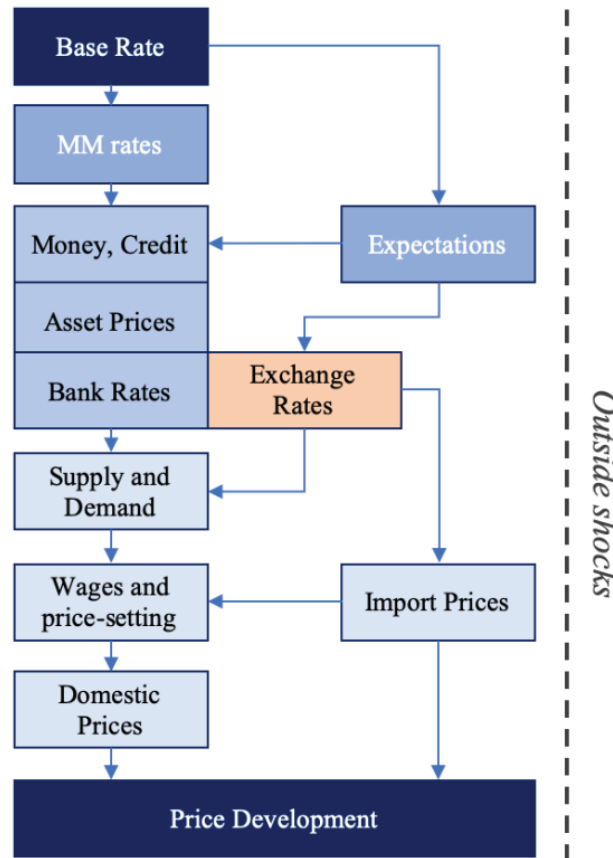


Figure 1 – Transmission Mechanism Scheme

Economic overview and recent changes

In 11th of March 2020, World Health Organization declared that novel coronavirus epidemic in China is considered pandemic as the number of infected people have been growing all around the world dramatically. This has led to massive measures taken by governments against the spread of virus in their local territory. Countries were closing their borders, cities were locking down. In consequence, most of the small and medium enterprises lost their streams of clients. Vast amount of air and ground transportation networks were cut influencing travel industry and affecting global supply chains.

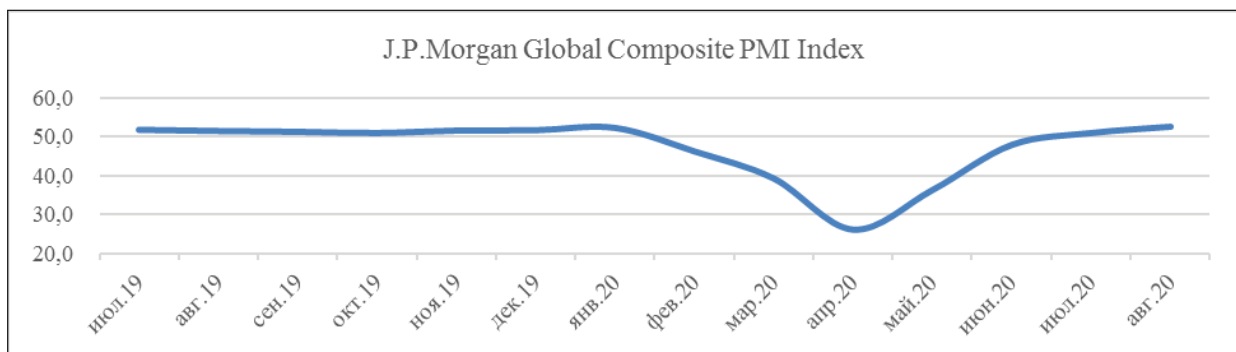


Figure 2 – J.P.Morgan Global Composite PMI

The commodity prices have been falling down since the beginning of the year as demand for goods shrink in the matter of weeks. The demand shortage mostly influenced oil, aluminum, steel, bitumen and nickel prices, as well as agriculture products such as milk. The demand could be traced through PMI index, that show the purchasing activity of manufacturing and service companies, where the index more than 50 indicates that activity is increasing and less than 50 the activity is falling [4].

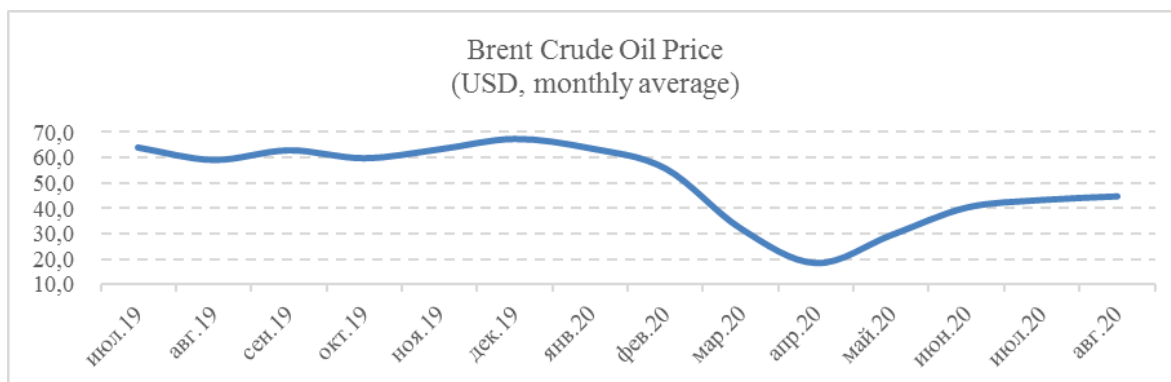


Figure 3 – Brent Crude Oil Price

NBRK response to pandemic. Base rate channel. Macroeconomic indicators of the country in 2020 were influenced by outside shocks. In addition to that, commodity prices were pressuring the exchange rate of national currency. In order to stabilize the economy, uphold asset prices and protect the exchange rate on 10th of March 2020 NBRK made an unscheduled decision to increase the base rate from 9,25% to 12.0%. NBRK also increased the range of corridor from +/- 1% to +/- 1,5%, respectively. This decision helped to hold down the demand for national currency, therefore reducing the pressure to exchange rate and decreasing the inflationary expectations of citizens and market participants. Later 6th of April 2020 NBRK decided to ease the policy by decreasing the base rate to previous 9,25%, but also widening the corridor to +/- 2,0% to leave more space for potential movements. This was meant to increase economic activity since the pandemic led to drastic slowdown in real economy operations. The base rate remained unchanged until 20th of July 2020, after the results of economic activity for 6 months 2020 were announced and GDP decline rate was less than forecasted targets. As the economic slowdown was continuing and inflationary expectations decreased the base was decided to be dropped to 9,0% with narrower corridor of +/- 1,5%.

Money supply channel. Anti-crisis measures managed by government, as consequence of retail loan subsidies and social payments to support citizens have led to increase in money base and money supply of the country. It can be seen that both the volume of deposits in the banks and cash on hand increased starting from the beginning of 2020.

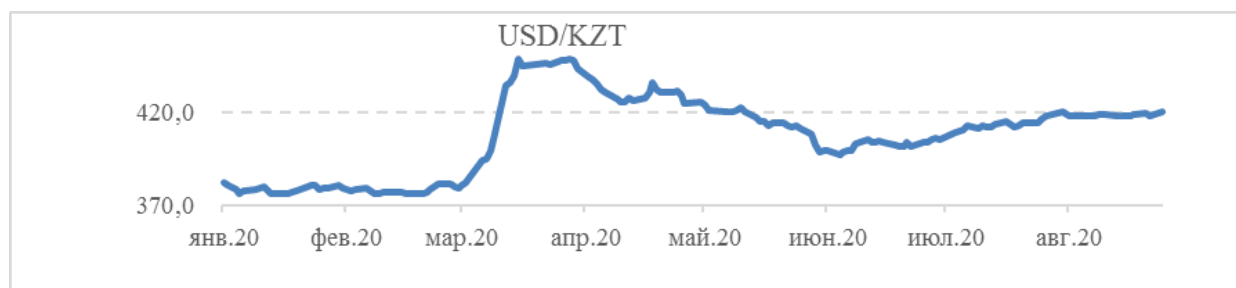


Figure 4 – USD/KZT Exchange Rate

Exchange rate channel. The exchange rate of national currency, as discussed before, was pressured by outside shock and particularly the change in commodity prices and exchange rates of countries – trading partners of Kazakhstan. Even though, the oil prices were steadily growing from June to August of 2020, the exchange rate of KZT was devolving.

This was explained by exchange rate of national currencies of neighboring countries. Moreover, USD itself was weakening due to increased demand for gold, which historically is an attractive investment during recession periods [5].

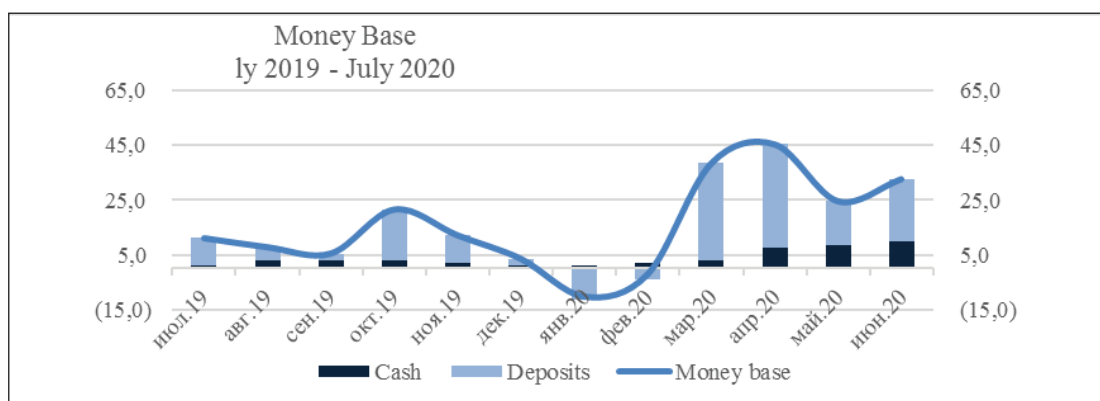


Figure 5 – Kazakhstan Money Base

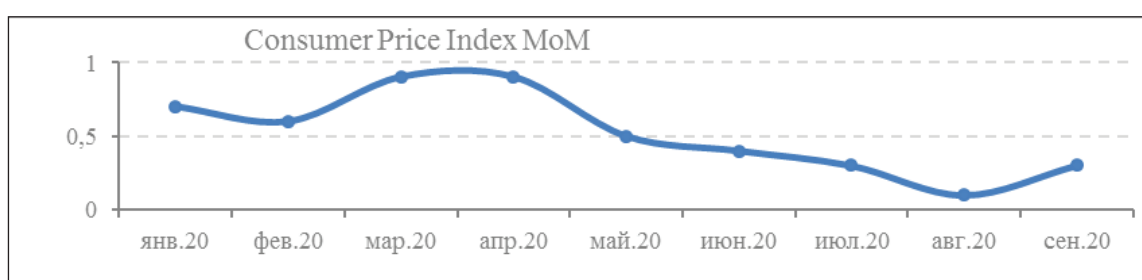


Figure 6 – Consumer Price Index Kazakhstan MoM

In conclusion, taking into account the global pandemic followed by economic slowdown due to interaction restrictions worldwide, it can be seen that generally NBRK is following an expansionary monetary policy. This can be seen through lowering decisions of base rate, increase of money supply and stabilization of currency. The "march" decision to increase the base rate up to 12% was an extraordinary decision. However, considering the specific characteristics of Kazakhstan economy and KZT price formation this was a reasonable reaction to such sudden and severe outside shocks. It can be seen, that overall consumer price stabilization (watch Consumer Price Index MoM) was achieved by NBRK as of September 2020.

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2020 ЖЫЛЫ ҚАЗАҚСТАН РЕСПУБЛИКАСЫ ҰЛТТЫҚ БАНКІНІҢ АҚША-КРЕДИТ САЯСАТЫНЫҢ ЖӘНЕ СЫРТҚЫ КҮЙЗЕЛІСТЕРГЕ ДЕН ҚОЮДЫҢ ТРАНСМИССИЯЛЫҚ ТЕТІГІ

Андатпа

Мақалада ақша-несие саясаты және Қазақстанның Ұлттық Банкінің трансмиссиялық механизмінің ерекшеліктері мен қазіргі жағдайы қарастырылады. Трансмиссиялық механизм қазіргі экономиканы дамыту мақсатында қойылатын міндеттерге жетудің құралы болып саналмайды. Бұл механизм экономикалық процестердегі өзара байланыстар жиынтығы, соның арқасында ақша-несие саясаты шеңберіндегі шешімдердің немесе операциялардың нәтижелері экономикаға әсер етеді. Осыған байланысты, мақалада инфляция деңгейі және оның тауарлар мен қызметтерге баға деңгейіне әсері баяндалады. ҚР ҰЭМ тұтыну тауарлары мен қызметтері қоржынындағы бағаларды талдау негізінде есептелетін инфляцияны есептеу үшін тұтыну бағалары индексін пайдалану жағдайы нақты талданады. Қазақстан Республикасының ақша-кредит саясаты үшін өміршең бағдарды көрсететін макроэкономикалық және микроэкономикалық факторлар тұтыну бағаларының индексін деңгейіне әсер етеді. Шешімдер қабылдау мақсатында ҚРҰБ инфляция бойынша болжамдарды анықтау үшін зерттеулер жүргізеді. Инфляциялық күтулер экономикаға ықтимал әсерді бағалауға мүмкіндік береді. Осы тұрғыда, мақалада ҚРҰБ инфляциясының нысаналы деңгейіне мынадай арналар (базалық бағам, айырбас бағамы және ақша массасы) арқылы қол жеткізілетіндігі туралы айтылады. Қорытындыда бүкіл әлемдегі жаһандық пандемияны ескере отырып, ҚРҰБ экспансионистік ақша-кредит саясатын және базалық мөлшерлемені төмендету, ақша массасын ұлғайту және валютаны тұрақтандыру туралы шешімдерді көруге болатындығына негізделген.

Тірек сөздер: трансмиссия механизмі, ақша-несие саясаты, қаржы, инфляция, пандемия, валюта, макроэкономика, микроэкономика.

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ТРАНСМИССИОННЫЙ МЕХАНИЗМ ДЕНЕЖНО-КРЕДИТНОЙ ПОЛИТИКИ РЕАГИРОВАНИЯ НАЦИОНАЛЬНОГО БАНКА РЕСПУБЛИКИ КАЗАХСТАН НА ВНЕШНИЕ ШОКИ В 2020 ГОДУ

Аннотация

В статье рассматриваются особенности и современное состояние денежно-кредитной политики и трансмиссионного механизма Национального банка Казахстана. Механизм трансмиссии не является инструментом для достижения целей, поставленных перед развитием современной экономики. Этот механизм представляет

собой совокупность взаимодействий в экономических процессах, посредством которых результаты решений или операций в рамках денежно-кредитной политики влияют на экономику. В связи с этим в статье описывается уровень инфляции и ее влияние на уровень цен на товары и услуги. Подробно проанализирована ситуация с использованием индекса потребительских цен для расчета инфляции, рассчитываемого на основе анализа цен в портфеле потребительских товаров и услуг МНЭ РК. Макроэкономические и микроэкономические факторы, отражающие жизнеспособное направление денежно-кредитной политики Республики Казахстан, влияют на уровень индекса потребительских цен. Для принятия решений НБРК проводит исследования для определения прогнозов инфляции. Инфляционные ожидания позволяют оценить возможное влияние на экономику. В этом контексте в статье говорится, что целевой показатель инфляции НБРК будет достигнут по следующим каналам (базовый курс, обменный курс и денежная масса). Вывод основан на том факте, что, учитывая глобальную пандемию во всем мире, можно увидеть экспансионистскую денежно-кредитную политику НБРК и решения по снижению базовой ставки, увеличению денежной массы и стабилизации валюты.

Ключевые слова: трансмиссионный механизм, денежно-кредитная политика, финансы, инфляция, пандемия, валюта, макроэкономика, микроэкономика.