

## Less Focus on the Dollar, More Focus on the Ruble: Currency Management Strategy in Kazakhstan, Post Devaluation

William G. Gissy\*

Vice-President for Strategic Planning and Development, KIMEP University, Almaty Kazakhstan

### Abstract

The tenge devaluation occurring on 13 February 2014, approximately 5 years after the previous devaluation, marked a change in focus on the part of National bank of Kazakhstan.

### Introduction

Business entities operating in Kazakhstan, as in other countries, place temporarily idle funds in interest bearing accounts. Local banks provide the option of accounts denominated in the local currency, Kazakhstani Tenge (KZT) or a foreign currency, principally Dollars, Euros or Rubles. However banks offer a higher rate on the KZT account so, for local enterprises, shifts between local currency and foreign currency accounts only occur if there are signals in the global interbank trading rates that indicate a depreciation due to a change in the level of intervention on the part of the country's central bank, the National Bank of Kazakhstan (NBK). More importantly, signals of a pending devaluation are key to shifting funds to foreign currency accounts, to protect the loss of foreign exchange values of their reserve funds.

The devaluation of tenge on 13 February 2014 not only initiated new values for the currency; it also marked a change in foreign exchange management strategy on the part of Kazakhstan's central bank. In an earlier study Gissy [1] observed that de facto changes in the National Bank of Kazakhstan's (NBK) exchange policy were driven by changes in their international reserves. Applying the taxonomy developed by Reinhart and Rogoff [2] it was determined that the NBK ran a peg with a depreciating crawl during 2001 and 2002. The Degree of flexibility was increased in 2003 when the NBK switched to a band that allowed an appreciating crawl. This regime held until December 2004 when a fixed parity peg was implemented. In January 2006 NBK introduced the relaxed policy referred to by Husain [3] with a degree of flexibility that exceeds that typified by a narrow band. This 6 month episode could be classified as either a wide band or managed float. During this period the tenge appreciated at an annual rate of 13.2 percent. In mid-2006 the central bank tightened up by reinstating a narrow band with a sharp depreciating crawl and maintained this policy for the remainder of 2006. In January 2007 the regime appears to revert to a managed float with a modest degree of appreciation in the Tenge's value. NBK maintained this policy until October 2007 when it embarked on another episode of fixed parity peg which lasted through July 2008. This regime was followed by a 3 month peg with appreciation followed by a 3 month period of sharp depreciation leading up to the devaluation in early February 2009.

The relaxation of controls between November 2008 and the devaluation in 2009 generated a 16.97 percent annual rate depreciation of the tenge with foreign currency reserves declining 13.24 percent. This was the only episode during the period January 2001-February 2009 when there was both an external depreciation of the tenge and a decline in foreign currency reserves. It was during this period, when one could observe the interbank trading rate exceeding the official limits and becoming asymptotic to the rate of 150 that a switch from a KZT account to a Dollar account was the appropriate currency management policy.

With the Act of the Republic of Kazakhstan "On Making Changes

and Additions to Some Legal Acts of the Republic of Kazakhstan Regarding Joint-Stock Companies" of July 10, 1998 coming into effect, the ban prohibiting the exchange to operate trading in foreign currencies and financial instruments other than securities, was lifted, which made it possible to affiliate the AFINEX to the exchange. The relevant decision was taken at a general meeting of shareholders on January 6, 1999, and on March 16, 1999 an appropriate state re-registration of the reunited exchange was affected.

### Prelude to the February 2014 Devaluation

The analysis in Gissy [1] indicated that during periods where the NBK maintained fixed parity and there was a decline in foreign currency reserves they would respond by relaxing controls and allowing the interbank trading rate to increase. However, applying the Reinhart-Rogoff [2] taxonomy to 2013, using end of month results, it appears as though the NBK followed a fixed parity rule through November before allowing a slight crawl that allowed for 3% depreciation by the end of January 2014, despite of declines in foreign currency reserves.

Foreign currency reserves were \$29.637 billion at the end of 2012. By the end of March they had fallen to \$26.649 billion. They increased to \$28.086 billion in April, fell to \$26.424 billion in May then increased to \$28.356 billion in June. By the end of November they had fallen to \$23,697 billion but gradually increased during December and January to \$24.678 billion. Analysis of daily data indicates that after the months of April and June the NBK allowed relaxation for a period during the month but kept the monthly change with a 1% limit. These periods of relaxation were associated with improvements in foreign currency holdings during these months.

The up and down movements of foreign currency reserves and the crawling depreciation that extended through January indicated that devaluation was on the horizon. It wasn't a question of "if" there was going to be a devaluation but "how much". The crawling depreciation occurring towards the end of 2013 was expected, given the persistent decline the decline in international reserves, but the magnitude of the devaluation exceeded what was necessary if the NBK was still

\*Corresponding author: William G. Gissy, Vice-President for Strategic Planning and Development, KIMEP University, Almaty Kazakhstan, Tel: 7-727-270-4466; E-mail: [wgissy@kimep.kz](mailto:wgissy@kimep.kz)

Received March 10, 2014; Accepted October 29, 2014; Published November 05, 2014

Citation: Gissy WG (2014) Less Focus on the Dollar, More Focus on the Ruble: Currency Management Strategy in Kazakhstan, Post Devaluation. J Stock Forex Trad 3: 132. doi:10.4172/2168-9458.1000132

Copyright: © 2014 Gissy WG. This is an open-access article distributed under the terms of the Creative Commons Attribution License, which permits unrestricted use, distribution, and reproduction in any medium, provided the original author and source are credited.

committed to merely stabilizing their international reserve holdings to the end of 2012 levels. Granted the level of foreign currency reserves at the end of 2012 was 16.17% below the peak value established in March of that year but resetting parity to 160 would have allowed modest growth in reserves given the results of April, June and December. Clearly there was another issue that influenced the magnitude of the devaluation and may give rise to changes in the way organizations operating in Kazakhstan engage in currency management.

Since the 2009 devaluation a major event in Kazakhstan's international economic relations occurred, namely membership in the customs union with Russia and Belarus. The devaluation significantly reduced the value of the Tenge against the Dollar and Euro relative to March 2012, the peak month for foreign currency reserves, but actually restored the Tenge's parity with the Ruble to its March 2012 level.

KASE has three categories of membership. Depending on the type of financial instruments an organization is interested to trade in, it can become a member of KASE's currency, stock or futures markets. It is also possible to enjoy simultaneous membership in two or three of these categories.

### The Russian-Kazakhstan-Belarus Custom Union

Since the launch of the customs union of Russia, Kazakhstan and Belarus on 1 January 2010, the trade between the three countries has been growing rapidly. Since 2009, overall trade among the three countries increased by over 25% by the end of 2010, and by 67% by the end of 2011.

Customs union was signed in November 2009 and launched in January 2010 when import tariffs of the three countries were harmonized. Standardization of other procedures started in mid-2010 when member countries enacted a common Customs Code. Customs controls were subsequently removed from internal borders between Kazakhstan and Russia and Russia and Belarus. Currently there are plans to pursue further integration within the framework of the Common Economic Space, with the ultimate goal of achieving free movement of goods, capital and labor.

By the end of 2011 trade volumes were still recovering from the 2008-09 crises. During this crisis period, Kazakhstan's imports contracted by 25% in nominal terms. Imports from future customs union members were most affected, contracting by over 33% compared with a decrease of 9% for imports from European Union members. In 2010 imports started recovering, primarily for goods from customs union members, while imports from the EU continued to decline. A growing dependence on trade within the custom union relative to the EU raises the question on the appropriate exchange rate policy for a member of a custom union and the prospects for the NBK to change their focus towards the ruble rather than the dollar.

### NBK Policy Revisited

Assessing economic conditions to determine an appropriate exchange rate regime can be problematic for several reasons. First, at the theoretical level, much of the comparisons are between flexible versus fixed regimes rather than nearly-fixed or managed regimes. Some conclusions concerning the benefits or costs of fixed regimes relative to flexible regimes may not be valid when applied to nearly-fixed or managed regimes. The more important factor, however, is the multitude of considerations; such as trade orientation, financial integration, economic diversification and inflation; that go into assessing the relative merits of an exchange rate regime. As Juhn and Mauro [4] and Rogoff et al. [5] point out, some factors may suggest a

fixed rate is preferable while others support the use of flexible rates, views that fit what is known as the Corner Hypothesis. As Husain [3] noted, no single factor consistently explains actual regime choice. Edwards and Savastrano [6] and Husain, Moody and Rogoff [7] examine the issue of regime choice, performance and the subsequent durability of alternative regimes. As Jeffrey Frankel [8] argues there is no one regime that is right for all countries or for all times

In the case of Kazakhstan, Frankel [9] rejected the Corner Hypothesis which contends that intermediate regimes are unstable and therefore countries should limit their choices to free-float or rigid pegs. His view is contrary to Stanley Fischer [10] who used anecdotal evidence to support the Corner hypothesis or what he terms the bipolar view on exchange rate regimes. Under this assessment a pegging of the Tenge to the Ruble would seem to make sense

According to Calvo and Reinhart [11] there is an additional factor to be considered, the "fear of floating" phenomenon. This occurs when countries have large external debt obligations enumerated in terms of the currency they use as a peg. Large fluctuations in the exchange rate could have significant balance-sheet effects which would then impact the corporate and banking sectors. Additionally large exchange rate movements could have serious inflationary impacts. At this point it would seem that the NBK is stuck between competing needs, maintaining a peg to the Euro of Dollar for international debt purposes and maintaining parity with the Ruble for trade purposes. Given the instability of the Ruble, it would virtually impossible for the NBK to maintain both Dollar and Ruble pegs. In terms of currency management, which currency will serve as the signal for a devaluation which would necessitate a shift in balances from Tenge to foreign currency.

The NBK must formulate an exchange policy for a country that is too large, too diverse across trading partners and too dependent upon a single export commodity for a rigid peg to a single currency. On the other hand the country is too small and in need of a nominal monetary anchor for free float to be an advisable option. This problem can be exemplified by the pegging the Tenge against the Dollar for most of 2013 while allowing it to appreciate against the Ruble. Although the appreciation generated the benefit of less expensive products from Russia it created the problem of making Kazakhstan's exports to Russia more expensive. Although the restoration of the Tenge-Ruble rate to its March 2012 value may be a onetime correction, the magnitude of the recent devaluation seems to indicate a need for currency managers operating in Kazakhstan to look more at the Ruble and exports to Russia and worry less about the Dollar and Kazakhstan's foreign currency reserves for projecting future devaluations or revaluations.

Today, this sector trades financial instruments of over 70 issuers, mainly stocks of local and foreign companies. The total shares market capitalization makes up more than 30 billion USD. The main bulk of the market is occupied by companies from mining, energy and financial sectors.

### References

1. William GG (2010) Classifying the Tenge-Dollar Regime, 2001-2008: An Application of the Reinhart-Rogoff Taxonomy. *Journal of Current Issues in Finance, Business and Economics* 3: 1-8.
2. Reinhart CM, Rogoff KS (2004) The Modern History of Exchange Rate Arrangements: A Reinterpretation *Quarterly Journal of Economics* 119: 1-48.
3. Husain AM (2006) To Peg or not to Peg: A Template for Assessing the Nobler. IMF Working Paper 06-54.
4. Juhn GS, Mauro P (2002) Long-Run Determinants of Exchange Rate Regimes: A Simple Sensitivity Analysis. IMF Working Paper 02-104.

- 
5. Rogoff, KS, Husain AM, Mody A, Brooks R, Oomes N (2004) Evolution and Performance of Exchange Rate Regimes. IMF Occasional Paper 229.
  6. Edwards S, Savastano MA (1999) Exchange rates in Emerging Economies: What Do We Know?: What Do We Need to Know?" NBER Working Paper 7228.
  7. Husain AM, Mody A, Rogoff KS (2005) Exchange rate Regime Durability and Performance in Developing versus Advanced Economies. Journal of Monetary Economics: 52: 35-64.
  8. Frankel J (1999) No Single Currency regime is Right for All Countries or at All Times. NBER Working Paper 7338.
  9. Frankel J (2005) On the Tenge: Monetary and Exchange rate Policy for Kazakhstan. Center for International Development Consultancy Paper.
  10. Fischer S (2001) Exchange Rate Regimes: Is the Bi-Polar View Correct? Journal of Economic Perspectives: 15: 3-24.
  11. Calvo GA, Reinhart CM (2002) Fear of Floating. Quarterly Journal of Economics 116: 379-408.