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MACROECONOMICS | KAZAKHSTAN

THE TENGE'S MODERATE VOLATILITY ALLOWS DEVALUATION RISKS TO BE REDUCED AND RESERVES TO BE MAINTAINED

The tenge's nominal exchange rate has only declined by a third since the floating rate was introduced, although the nature of volatility has changed

Since the tenge transitioned to free exchange rate formation at the end of 2015, the corridor of fluctuations in the exchange rate of Kazakhstan's national currency against the US dollar shows a trend toward a slow weakening of the tenge. However, from early 2016 (which corresponds to 100) to October 2023, the tenge exchange rate index ranged from 133 to 136, i.e. over eight years the national currency only lost of third of its value, despite the fairly widespread belief that there is a persistent and significant potential for impairment (*Fig. 1*).

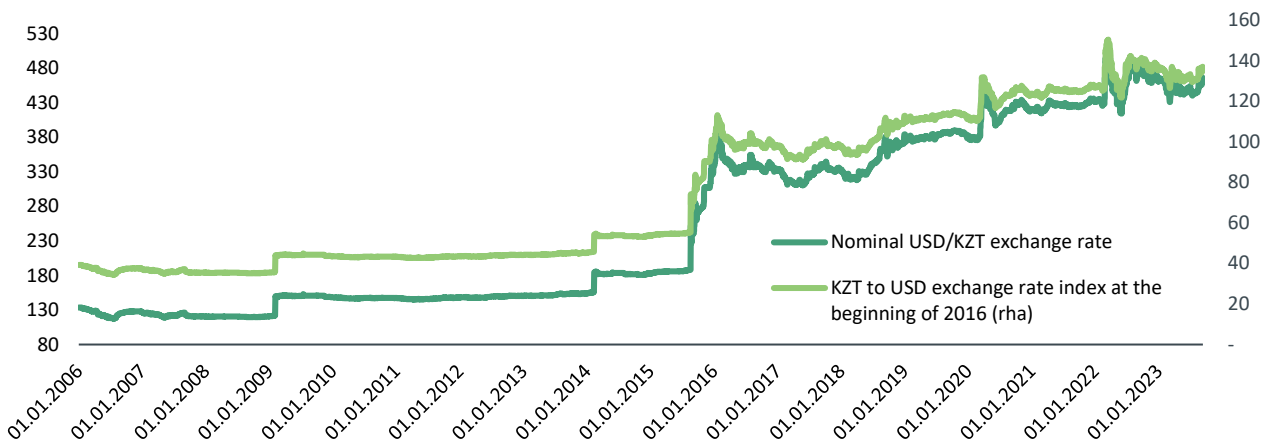
When assessing the tenge exchange rate dynamics, its overall trajectory, as well as the degree of volatility of the Kazakh currency, which has its own specifics, should be taken into account. Analysis of data for the past few decades allows us to draw a number of conclusions.

Firstly, after the transition to a free exchange rate, the frequency of episodes of heightened tenge volatility increased sharply. Until the end of 2015, there were hardly any of these episodes, and each of them (when exchange rate fluctuations reached 60–100% of the maximum for the entire period) was an event. In 2019–2021, volatility was minimal, but since 2022 it has increased, and episodes of its slight increase have also become more frequent.

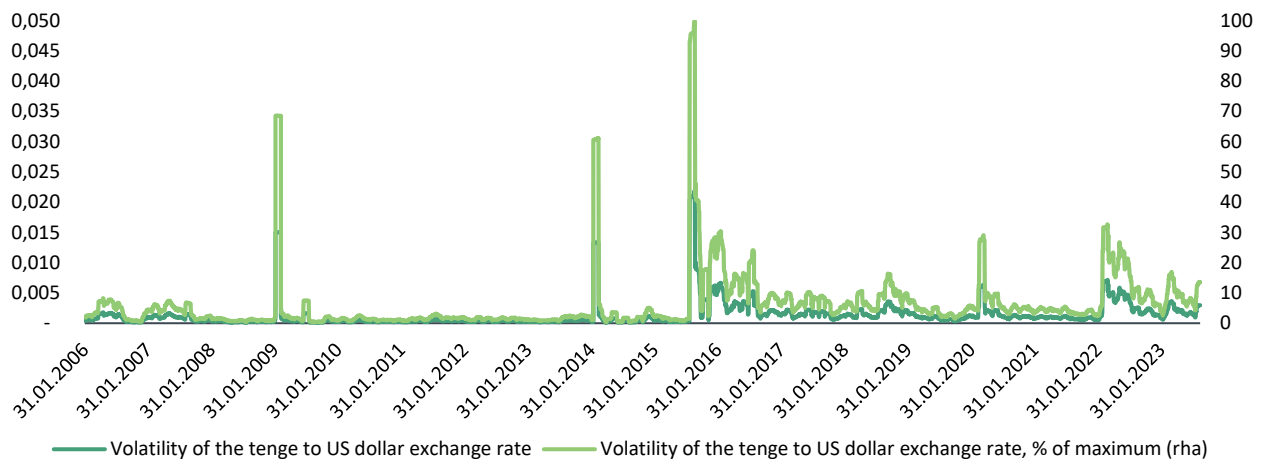
Secondly, under the free exchange rate regime, the growth in volatility has been disproportionately weaker compared to the rare episodes of growth observed before the end of 2015. Compared to the peak recorded in August and September 2015, episodes of increased volatility in recent years have only been up to 32% in strength.

Thirdly, prior to 2015 — the period during which the exchange rate corridor was in place and the regulator actively intervened — the tenge's volatility was almost always around zero (with the exception of the abovementioned episodes), especially between 2008 to 2015. Volatility has never been close to zero since the free float was introduced.

In general, the currency regime currently in place in the country has led to a change in the specific volatility of the tenge exchange rate. This regime absorbs the risks of devaluation, which is reflected in consistent but low volatility amid a trend toward insignificant, in relative terms, weakening of the tenge.

Figure 1. Nominal tenge exchange rate and tenge exchange rate index since the start of 2016

Sources: NBC, ACRA

Figure 2. Calculated volatility of the tenge to US dollar exchange rate¹

Sources: NBC, ACRA

Containing the volatility of the tenge until 2015 and adjusting the exchange rate during the transit period required large foreign exchange interventions

The regulator's foreign exchange interventions consisted of and consist of both the sale of currency to the market and its withdrawal from the market. This analytical commentary examines the monthly net values of interventions when the National Bank of Kazakhstan (NBK) predominantly sold foreign currency in some months and bought in others.

By analogy with the dynamics of the nominal exchange rate of the tenge within the analyzed period (from 2006 to 2023), we can distinguish time intervals that are characterized by different natures of foreign exchange interventions. Up to and including 2013, interventions took place almost every month and were significant. At the same time, the volumes of currency purchases were almost balanced by the volumes of sales, thereby reducing the potential volatility of the exchange rate. The nature of interventions has changed since 2014. From 2006 to 2013, the regulator sold only about USD 570 mln in net terms, yet in the next (transit) period — from 2014 to 2015 — currency sales dominated and amounted to USD 35.1 bln in net terms (which exceeds the NBK's international reserves — USD 31.93 bln as of September 2023).

¹ Calculated as the standard deviation of the first difference in the logarithms of daily exchange rate levels for the last month, equal to 30 calendar days by default.

In the third period, which began in 2016 and continued this year, interventions in net terms were more infrequent — the regulator resorted to them only in individual months in 2016 and 2020. The aggregate of net sales from 2016 to September 2023 was USD 417 mln, or 13% of current international reserves.

Prior to the transition to the free exchange rate regime, intervention activity was high, which limited the tenge's volatility (according to the requirements of the exchange rate regime in place at the time). During the transit period from 2014 to 2015, significant foreign exchange reserves were spent in net terms to adjust the exchange rate, the need for which was associated with long-term artificial containment of both the exchange rate itself and its volatility in the previous period.

Is it appropriate to talk about current account volatility that causes major fluctuations in the exchange rate?

Noticeable volatility of items in the balance of payments generally translates into exchange rate instability, which reflects trends in the external sector of the country's economy.

Let us consider the specifics of the current account of the balance of payments, since the balance of payments itself is reduced to balance form due to reserve transfers and residual errors and omissions.²

Below are the main conclusions regarding the trends characteristic of the current account (CA) of Kazakhstan in the period from 2000 to H1 2023.

1. Since 2000, the standard deviation covers a significant portion of the average CA value for the analyzed period (40–77%, depending on the item), which indicates rather high volatility of CA items.
2. Trade in goods accounts for two thirds of the CA volatility (43% and 24% for exports and imports, respectively), payments to non-residents on primary income — 17%, other items — 2–6%. This indicates high concentration of sources of volatility.
3. Analysis of the dynamics of deviations of the sum of CA items from the average value for the period allows us to identify the following time intervals of the highest deviations: 2011–2014, when the volatility containment regime was in effect within the currency corridor, 2018–2019 and 2021–2023, during the free exchange rate of the tenge.

Before August 2015, there was potential for higher volatility of the tenge due to the dynamics of CA items (see *Fig. 3*), which was largely restrained by the currency corridor regime, while the high volatility of 2015–2016 was not directly related to the CA (*Fig. 4*). Apparently, the increase in exchange rate volatility occurred at that time as a result of devaluation expectations accumulated in previous years, which can be regarded as a one-time event within the transit period.

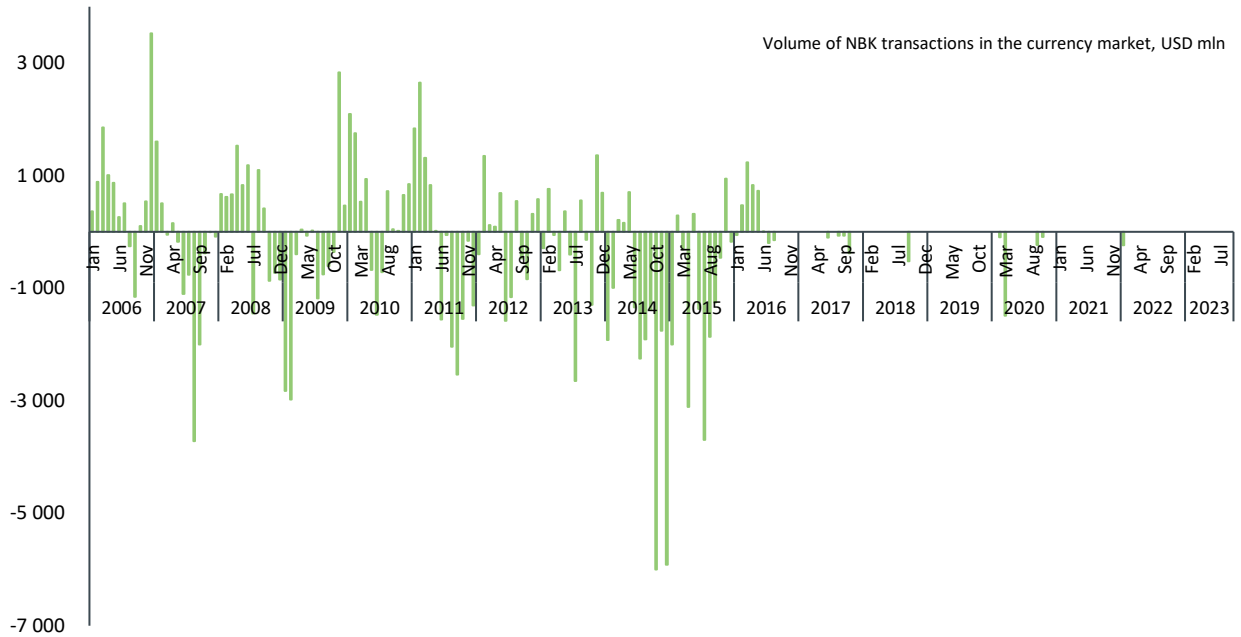
The low but almost constant volatility of the tenge exchange rate observed in recent years may be explained to some extent by the volatility of CA items, but this effect is smoothed out by the free exchange rate regime in the absence of major currency interventions.

In ACRA's opinion, the high volatility of the tenge exchange rate in the transit period from 2015 to 2016 was not caused by the fundamental pressure of volatility in the country's external accounts, but by the transition to the new currency regime, which was conditioned by the dynamics of the exchange rates of Kazakhstan's trading partners.

² This commentary estimates the spread of values of major CA items, that is, the sum of the main CA items modulo (trade in goods and services, payments and receipts on primary and secondary income), but not their reduction to balance sheet form. In this regard, when calculating volatility, both debit components (due to external accounts modulo) and credit components (due from external accounts modulo) are taken into account. The resulting sum of the main positions is assumed to be equal to 100% when calculating the distribution of the desired spread.

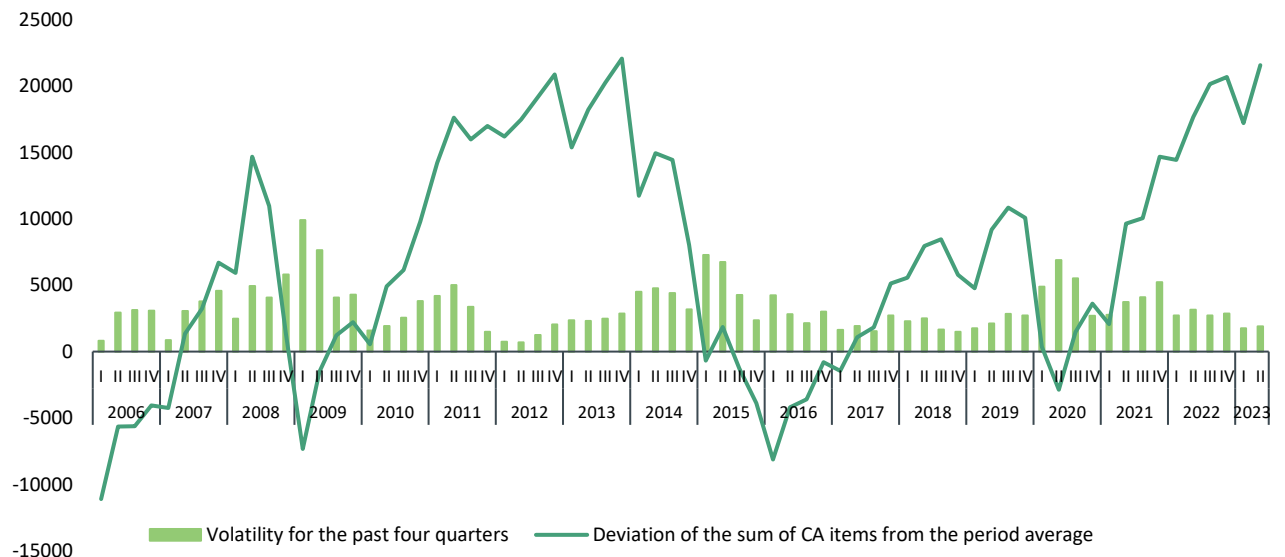
In 2022–2023, an increase in the volatility of CA items is being observed. This is a more fundamental imbalance that exerts some pressure on the Kazakh currency, however, due to the current free exchange rate regime, major fluctuations in the tenge exchange rate are leveled. At the same time, there is no need for currency interventions by the regulator, since the constant but low volatility of the national currency does not carry the risk of significant devaluation.

Figure 3. Net interventions of the NBK, USD mln (negative values = currency sales to the market)



Sources: NBK, ACRA's calculations

Figure 4. Volatility of CA items, USD mln



Sources: NBK, ACRA's calculations

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