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CCAMTAC and Joint Vienna Institute (JVI)

Regional Joint Webinar on

“Regional Economic Outlook: Inflation Dynamics and Spillovers of US Monetary Policy”

Wednesday, May 25, 2022

Introduction:

Mr. Norbert Funke, Director, CCAMTAC

Moderator:

Patrick Imam, Deputy Director, Joint Vienna Institute

Presenters:

Mr. Filippo Gori, Economist, Middle East and Central Asia Department, IMF

Mr. Mohamed Belkhir, Economist, Middle East and Central Asia Department, IMF

Country Interventions:

Mr. Azat Kozubekov, Head of Economic Department, National Bank of the Kyrgyz Republic

Mr. Hayk Avetisyan, Head of Monetary Policy Department, Central Bank of Armenia

Mr. Rustem Orazalin, Head of Monetary Policy Department, National Bank of Kazakhstan

Ms. Urgamalsuvd, Head of Division, Monetary Policy Department, Bank of Mongolia

In its latest publication, the IMF's Middle East and Central Asia Regional Economic Outlook (REO) included analytical chapters dedicated to inflation dynamics and spillovers of tightening US monetary policy on the region. Inflation has become a global phenomenon, initially due to supply chain disruptions brought about by the pandemic, but price dynamics have since been exacerbated by the war in Ukraine and subsequent increase in commodity and food prices. The cycle of rising interest rates also adds pressure to emerging economies already hit by the COVID-19 pandemic. Moderator Patrick Imam emphasized that these topics are of high importance for policymakers in Caucasus, Central Asia and Mongolia (CCAM) as they try to tame inflation and avoid economic recession while preventing capital outflows. This webinar aimed to support peer exchanges in the region amid high economic uncertainty.

In the first presentation IMF economist Filippo Gori, gave a structured overview of the inflation dynamics and its drivers in the Caucasus and Central Asia (CCA) and discussed the impact of global shocks on domestic inflation. Headline inflation in CCA was rising even before the pandemic and continued to surge after 2021. Despite differences in the structure of economies and policies, most countries in the region have similar upward inflation paths. The question is whether inflation has been accelerating largely due to external or domestic factors.



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Overall, external factors have been the main driver of price dynamics in the region, both historically and in the current episode. International food prices have the highest impact on domestic prices, even if the pass-through is relatively short-lived. The pass-through of oil prices matters only for a subset of countries in the region, mainly oil-importers, while supply-chain disruptions appear to affect domestic inflation with the longest lag. In addition, the augmented Phillips curve estimations suggest a limited role of domestic demand in driving inflation, however, there is some evidence that expansionary fiscal and monetary policies and the strength of the ongoing recovery are associated with the recent surge of inflation. From the monetary policy perspective, short-term inflation expectations have risen above the inflation target for several countries, whereas long-term inflation expectations remained broadly anchored.

In the second part of the webinar, IMF economist Mohamed Belkhir focused on the implications of US monetary policy normalization for the Middle East and Central Asia (ME&CA) economies. Portfolio inflows to the ME&CA region could decline substantially, particularly under a scenario of aggressive tightening by the Fed and heightened global risk aversion. A rise in US interest rates results in adverse spillovers to equity markets, exchange rates, sovereign yields, and the real economy, but countries with stronger fundamentals suffer a lower rise in their sovereign yields. Strong fundamentals also mitigate the adverse impact of a rise in global risk aversion on ME&CA countries' portfolio flows, which tend to be more sensitive to global financial conditions than in other EM economies. While elevated vulnerabilities and war-induced market volatility are likely to amplify spillovers in EM, high oil prices are expected to reduce oil exporters' vulnerabilities, which is beneficial for several countries in the CCAM region.

During the discussion, representatives from the monetary authorities from the Kyrgyz Republic and Kazakhstan shared their perspective on domestic inflation dynamics, key drivers of inflation (e.g. food and non-food items, services) and commented on the policy response of respective central banks to the rising inflation. In addition, they briefly touched upon how the war in Ukraine has been affecting their economies. Authorities from Armenia and Mongolia shared their assessment of global financial conditions and prevailing risks for the region and considered measures that could reduce countries' exposure to those risks. They also discussed different outcomes that could result from the US monetary policy tightening, including hard landing/recession and further inflation acceleration.

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