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CCAMTAC- Regional Research/Analytical Economic Policy Seminar

“Reducing Dollarization in the Caucasus and Central Asia”

Thursday, December 14, 2022

Introduction and moderation:

Norbert Funke, Director, CCAMTAC

Presenter:

Selim Cakir, Resident Representative for Georgia, Middle East and Central Asia Department, IMF

Discussant:

Shalva Mkhatriashvili, Head of Macroeconomics and Statistics Department, National Bank of Georgia

Declining but still, high dollarization rates in the Caucasus and Central Asia (CCA) region affect macroeconomic stability, monetary policy transmission, and financial sector development. Although several studies have investigated the dynamics of dollarization in the CCA, the relative roles of macro-financial policies and financial market development in the de-dollarization process have not yet been assessed empirically. The [IMF's working recent paper](#) takes stock of de-dollarization efforts and explores the short-term drivers of financial de-dollarization in the CCA region.

Selim Cakir, the co-author of the research paper, started his presentation by giving an overview of dollarization trends in the region. It was pointed out that the CCA countries historically had a high level of dollarization but it has been declining over the last decade. Several countries in the CCA region managed to reduce dollarization in an environment when their currencies were depreciating which was a difficult task. Prudent macroeconomic policies, de-dollarization policies, macroprudential measures, and the switch to floating exchange rate regimes contributed to this gradual decline. A downward trend was observed both in deposit and credit de-dollarization, but the latter was much more pronounced due to regulatory factors, such as restrictions on foreign currency lending, as well as supply and demand factors.

Most of the countries in the region have an official de-dollarization policy in place. To mitigate the risks associated with foreign currency assets, the authorities have introduced macroprudential and administrative measures. The analysis in the paper revealed that various prudential measures, increased spreads between local and foreign currency deposits, and exchange rate appreciation played a role in de-dollarization in the region. More specifically,



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(i) increasing the spread between reserve requirement ratios on foreign currency and local currency contributed to deposit and credit de-dollarization in several countries, (ii) various prudential measures such as discouraging bank lending in FX to unhedged borrowers contributed to credit dollarization in Georgia, Kazakhstan, Kyrgyz Republic, (iii) the impact of an exchange rate appreciation shock on deposit de-dollarization was immediate and significant in Armenia and Kazakhstan, and (iv) deposit dollarization in Azerbaijan and Kazakhstan responded to changes in the spread between local and foreign currency deposit rates. Surprisingly, countries' efforts to extend the yield curve and develop the domestic debt market did not produce sufficient results in de-dollarization perhaps due to the relatively low level of market development.

In his comments, Shalva Mkhatriashvili shared the experience of Georgia in reducing dollarization over the past years. He pointed out that despite the decoupling of deposit and loan de-dollarization, the latter is crucial for the monetary authorities from an inflation targeting (IT) perspective. High dollarization weakens the interest rate channel, making the monetary policy less potent in controlling inflation. Shalva Mkhatriashvili also discussed various measures that the National Bank of Georgia took to reduce economic agents' reliance on foreign currency. They included moving to IT regime and floating exchange rate, higher reserve requirements, higher interest rates on FX loans, and other macroprudential measures. He also emphasized that while there are some natural forces that may decouple deposit and loan dollarization, like improvements in domestic currency liquidity management and banks' capital, there still is some limit to that. Hence, for sufficiently significant de-dollarization, deposit and loan sides become equally important.

During the general discussion, the questions to the speakers covered: (i) the real sector dollarization, (ii) mortgages in foreign currency, (iii) reasons behind the high level of natural dollarization in Georgia, and (iv) the persistence of de-dollarization trend during the pandemic.

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