IMPLEMENTATION OF ECONOMY DEDOLLARIZATION MEASURES IN EDB MEMBER STATES
**SPECIAL REPORT.**
**IMPLEMENTATION OF ECONOMY DEDOLLARIZATION MEASURES IN EDB MEMBER STATES**


A highly dollarized economy is a distinctive feature of countries in the EDB region. This imposes constraints on the effectiveness of monetary and fiscal policies, exposes the economy to external shocks, and increases both the risks of financial instability and inflationary risks, sensitivity to which increases as the level of dollarization rises.

After studying the evolution of this phenomenon in some of the EDB member states in 2005-2015, a number of experts have concluded that the elevated level of dollarization is caused by: high inflation and exchange rate management instruments (hard peg, crawling bands, etc.), macroeconomic volatility (especially as regards inflation), and a fear of a floating exchange rate. One of the underlying macroeconomic factors behind dedollarization is a flexible exchange rate policy that makes the exchange rate more volatile than price fluctuations, along with the implementation of measures aimed at curbing and stabilizing inflation relative to an acceptable target level. The string of events occurring in the foreign exchange and monetary sectors of EDB member states in 2014-2015 resulted in a spike in dollarization, which eventually gave way to dedollarization of the regional economies.

**DOLLARIZATION TRENDS**

The rapid devaluation of national currencies between 2014 and 2016 was accompanied by a growing share of foreign currency deposits within the structure of the broad money supply in all EDB member states (Chart 1). At the end of 2015, the highest level of dollarization of deposits was recorded in Tajikistan, and the lowest in Russia, at 41.1% (the share of foreign currency deposits within the structure of the broad money supply).

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It stands to mention that the share of foreign currency deposits increased due both to changes in the savings preferences of economic agents in favor of instruments denominated in foreign currencies and to the effect of revaluation caused by the weakening of national currencies against the US dollar.

External shocks faced by EDB member states in 2014-2015 forced the monetary authorities of some countries in the region to change their approach to monetary policy. The central/national banks of Russia (in late 2014) and Kazakhstan (in mid-2015) announced a transition to inflation targeting and a floating exchange rate. The National Bank of Belarus switched to monetary targeting in early 2015, allowing the exchange rate to reflect market forces. The central/national banks of Armenia, Kyrgyzstan, and Tajikistan kept their old approaches to monetary policy while trying to limit exchange rate volatility using available tools. Countries with sufficient international reserves resorted to foreign currency interventions to support the exchange rate of the national currency. A number of central/national banks raised their benchmark interest rates and changed the mandatory reserve assets ratios. Some central/national banks complemented their economic levers to support the exchange rate with administrative measures.

Regardless of whether or not approaches to monetary policy were changed, the level of dollarization showed a discernible downward trend in the economies of all EDB member states as the pressure on their domestic foreign exchange markets eased up. The level of dollarization decreased from 71% in January 2016 to 60.4% in July 2017 in Belarus, and from 51.6% in January 2016 to 31.8% in July 2017 in Kazakhstan (Chart 1).

**MEASURES TAKEN**

The primary measures to bring down the level of dollarization of the economies of Eurasian Economic Union member states are systematized in Table 1.

Most of the countries in question have typically resorted to active dedollarization measures that directly stimulate the use of the national currency. Such measures include:

- Higher differentiation of mandatory reserve assets ratios. In Belarus, for example, the reserve assets ratio for foreign currency deposits of banks has increased twofold to 15% since the beginning in 2017 while being lowered by 3.5 percentage points to 4% for deposit liabilities denominated in roubles;

- Higher differentiation in the prudential requirements and facilitation of the conversion of foreign currency receivables into the national currency. Armenia and Belarus have adopted more stringent approaches to the classification of foreign currency liabilities for calculating the special reserve for assets exposed to credit risks. Kyrgyzstan has prohibited the issuance of US dollar-denominated loans to households. Individuals may take out a foreign-currency loan in Kazakhstan only if they have income in the currency of the loan;

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Launch of an extensive campaign to bring about a transition to universal use of the national currency as a means of exchange and payment. Most EEU member states have prohibited the practice of denoting prices, tax rates, utility rates and other payable fees in foreign currencies or have instituted tighter controls over pricing. Belarus has stopped issuing new and prolonging existing permits to use foreign currency as payment for air transportation and medical services provided to individuals. Kazakhstan has instituted new e-commerce rules: the e-commerce intermediary must set prices for goods exclusively in the national currency. Kyrgyzstan and Kazakhstan have prohibited setting prices for goods and services in so-called “conventional units”.

Among the passive measures designed to ensure a favorable market situation and create conditions favoring changes in the structure of future cash flows, the following merit special note:

- Phasing out practices that encourage the use of foreign currencies to the detriment of the national currency: public borrowing predominantly in the national currency (Armenia); and transition to the practice of applying different taxation conditions to deposits in national and foreign currencies (Belarus);
- Stimulation of the development of the institution of foreign exchange risk hedging (Belarus);
- Improvement of the infrastructure and gradual liberalization of the domestic foreign exchange market in the majority of countries in question.

In terms of the measures taken, the EDB member states provisionally fall into either a group of countries that have ensured a more flexible foreign exchange rate in addition to other economy dedollarization measures (Belarus, Kazakhstan, and Russia) or a group of countries that have actually restricted changes to their nominal exchange rates (Armenia, Kyrgyzstan, and Tajikistan).

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**Chart 3. Changes in foreign currency deposits**

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**Chart 4. Interest rates for foreign currency deposits for a term of 1 year or more (%)**

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**Source:** Central Banks, calculations by the authors

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*Analysis is based on an assumption that foreign currency deposits in EEU countries are entirely denominated in US dollars.*
PRELIMINARY CONCLUSIONS

If one excludes the factor of currency movements, it becomes obvious that countries in the former group have made greater progress than countries in the latter group (Chart 3). Even though foreign currency deposit interest rates in Tajikistan decreased in July 2017 to 7.0% from 16.0% (the highest level over January 2013-June 2017), the dollarization growth rate started to accelerate in the latter half of 2016. While foreign currency deposit interest rates have decreased in Russia and Kazakhstan less drastically, the dollarization rate in these countries has declined more appreciably from the 2013 level. Foreign currency deposits in Kazakhstan in August 2015 amounted to 236% of the 2013 level vs. a mere 149% of the 2013 level in July 2017.

Despite the reduction in interest rates for foreign currency deposits in Armenia, the volume of foreign currency deposits has been rising steadily since 2013 (if one excludes the factor of foreign currency movements). The Armenian dram is the only regional currency to have demonstrated relative stability since early 2015. Despite the fact that the Armenian monetary authorities have a longer experience with inflation targeting compared to the other countries in the region, their monetary policy has a number of features that you will not normally see in inflation targeting in its pure form. Efforts to curb foreign exchange rate fluctuations combined with other factors create preconditions for high dollarization\(^7\). If central banks try to curb inflation by maintaining their national currencies, their exchange rates will be less variable than the inflation rate. Under such conditions, foreign currencies will yet again become more attractive, meaning that the desired effect will not be achieved.

If one excludes the factor of currency movements, Kyrgyzstan experienced a significant slowdown of the dollarization growth rate in the first months of nominal strengthening of the national currency, which later gave way to stagnation. Administrative measures aimed at bringing down the level of dollarization in Kyrgyzstan were accompanied by measures to curb volatility in the exchange rate of the national currency.

Belarus experienced a substantial reduction in foreign currency deposits, mainly deposits of households, in 2016. This was caused both by the dedollarization measures taken and the striving of the population to maintain their customary standard of living in the face of shrinking real disposable incomes by spending their foreign currency savings. Foreign currency deposits of private customers with Belarusian banks virtually stopped decreasing in the first half of 2017. Meanwhile, the growth in foreign currency deposits recorded in April - June 2017 as shown in Figure 4 is attributable exclusively to the resolution of the oil and gas dispute between Belarus and Russia: Gazprom Transgaz Belarus deposited some of the funds received from the Belarusian Government as payment of the debt owed for Russian gas imports in foreign currency accounts with Belgazprombank.

CONCLUSIONS AND RECOMMENDATIONS

While it is still too soon to draw conclusions about the impact of structural factors on the level of dollarization in EDB member states, preliminary results of the past year and a half so far support the proposition that a policy of a flexible foreign exchange rate and the implementation of measures aimed at curbing and stabilizing inflation are among the underlying factors behind the reduction in the level of dollarization. Having switched to a floating exchange rate and implemented measures to stabilize inflation, Russia and Kazakhstan so far demonstrate better progress in lowering the level of dollarization. Meanwhile, other EDB member states – while implementing a more or less similar set of administrative measures aimed at dedollarization of the economy – achieved less progress in reducing the dollarization of savings while attempting to curb the volatility of the national currency.

Subsequent dedollarization measures in the EEU member states should be subdivided into three groups (corresponding to the above-mentioned features).

Measures of the first order – strategic measures – aim to improve the macroeconomic environment by achieving low and stable inflation and subsequently gradually increasing the flexibility of the exchange rate. These are the priority measures for EDB member states, since it was specifically the historically high level and volatility of inflation and the use of a pegged exchange rate during periods of foreign exchange market turbulence that acted as the primary causes of high dollarization in the countries of this integration association. Unless the priority measures are implemented effectively, there is a high risk that all subsequent dedollarization measures will not have the desirable positive outcomes.

Measures of the second order are passive. They are meant to create conditions that would limit the adverse effects on the economy, which may result from an incomplete implementation of the first-order measures. This group of measures should contribute to the convergence of the actual dollarization level to a level consistent with the objectives of the ongoing monetary policy. According to a joint study by the EEC and the EDB Center for Integration Studies, passive measures are more focused on credit operations of banks, since private deposit trends take shape under the influence of reasons and conditions that are often unrelated to the level of interest rates.

Measures of the third order (active measures) complement the above-mentioned measures and are directly aimed at stimulating the use of the national currency. Without effective implementation of first-order and second-order measures, the third-order measures will – at best – have no meaningful effect on the dollarization level. At worst, they can destabilize the financial system. According to Demidenko et al. (2016), “measures of the third order are meant, first, to guard the most vulnerable segments from foreign exchange risks and, second, to render unacceptable a banking model based on the mechanical transfer of foreign exchange risks to customers”.

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Table 1. Measures taken by EDB member states in the monetary and foreign exchange sectors

<table>
<thead>
<tr>
<th>Armenia</th>
<th>Basis of monetary policy</th>
<th>Foreign exchange regime</th>
<th>Other measures aimed at dedollarization</th>
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|         | Inflation targeting regime preserved | Managed floating exchange rate preserved | • Public debt securities are issued inside the country in the national currency;  
• The interest rate range has been narrowed and new instruments instituted for short-term liquidity management;  
• Differentiated rates are used for reserve assets ratios in respect of liabilities denominated in national and foreign currencies, and the dram is used as the currency of the reserves;  
• Net open position limits denominated in a foreign currency are regulated;  
• The largest banks are monitored for any foreign currency position mismatches;  
• The weight of foreign currency assets is increased in credit risk calculations;  
• National currency deposits enjoy a more substantial insurance guarantee;  
• It is prohibited to set prices and issue loans denominated in foreign currencies. |

| Belarus | Transition to a monetary targeting regime | Transition from national currency pegging to a foreign currency basket to a continuous order matching auction | • Increasing the ratio of placements for banks and non-bank credit and finance institutions with the mandatory reserve fund (reserve assets ratio) from 11% to 15% on foreign-currency deposits;  
• Discontinuing the practice of issuing new and prolonging existing permits to use foreign currency as payment for air transportation and medical services provided to individuals;  
• Discontinuing the issuance of new and renewal of existing individual permits for insurance companies to receive premium payments in foreign currencies under personal life insurance contracts, including additional pension insurance contracts.  
• The Government and the National Bank approved an economy dedollarization plan in early 2017. It provides for measures aimed at reducing the use of foreign currencies in payments between contracting parties and payments of duties, taxes and other charges, or as the equivalent measure of value when setting tariffs, rates, and prices. The core measures of the approved plan should be implemented in 2017-2018. |
<table>
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<tr>
<th>Country</th>
<th>Transition to an inflation targeting regime</th>
<th>Transition from a crawling band to a managed floating exchange rate</th>
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| Kazakhstan| Transition from a crawling band to a managed floating exchange rate | • The amount of compensation guaranteed to depositors by the Kazakhstan Deposit Guarantee Fund has been increased from 5 million tenge to 10 million tenge;  
• A phased increase in the maximum interest rate recommended by the Kazakhstan Deposit Guarantee Fund for private deposits from 9% to 14% for tenge deposits, and a reduction from 4.5% to 2% per annum for foreign currency deposits;  
• Following the transition to the floating exchange rate, a mechanism was instituted for compensating private depositors with deposits in the national currency for the currency difference;  
• Individuals who have not received income in a specific foreign currency over the past six months are prohibited from taking out mortgage loans in that foreign currency;  
• Measures have been instituted to discourage banks from issuing foreign currency loans by obligating them to increase capital;  
• The profit margin has been increased: the profit margin between foreign currency sale and purchase rates is 6 tenge for the US dollar and 7 tenge for the euro;  
• New e-commerce rules have been instituted: the e-commerce intermediary must set prices for goods exclusively in the national currency;  
• Prohibition of the practice of setting prices for goods and services in so-called “conventional units”. |
| Kyrgyzstan| Mixed monetary policy regime preserved | Managed floating exchange rate preserved |
| Russia    | Transition to inflation targeting regime | Transition from a crawling band based on the dual-currency basket to a managed floating exchange rate |
|           |                                          | • Program to convert mortgage loans denominated in foreign currencies into soms;  
• Prohibition to issue consumer, mortgage or other loans to households in dollars;  
• Prohibition of the practice of setting prices for goods and services in so-called “conventional units”. |
|           |                                          | • Reserve assets ratio: for liabilities in the Russian currency – 5.0%; for liabilities in a foreign currency – 7.0%. |
| Tajikistan | Foreign exchange rate targeting regime preserved | Foreign exchange rate targeting regime preserved | • All foreign exchange kiosks that are not owned by commercial banks have been closed;  
• More stringent controls have been instituted to make sure commercial transactions in Tajikistan are carried out exclusively in somoni;  
• Money transfers arriving in Russian roubles are issued to beneficiaries in somoni only;  
• Commercial banks are obligated to sell one half of foreign currency (rouble) revenue obtained via money transfers on the interbank market;  
• The official exchange rate may not deviate from the weighted average exchange rate set from trading on the interbank and intra-bank markets by more than +/- 1.5%. |

**LIST OF REFERENCES**


7. National Bank of the Kyrgyz Republic URL: www nbkr kg


9. Central Bank of Armenia URL: www cba am