

Central Bank of the Republic of Armenia



# FX Interventions under Risk Management Approach to Monetary Policy

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Governor of the Central Bank of Armenia

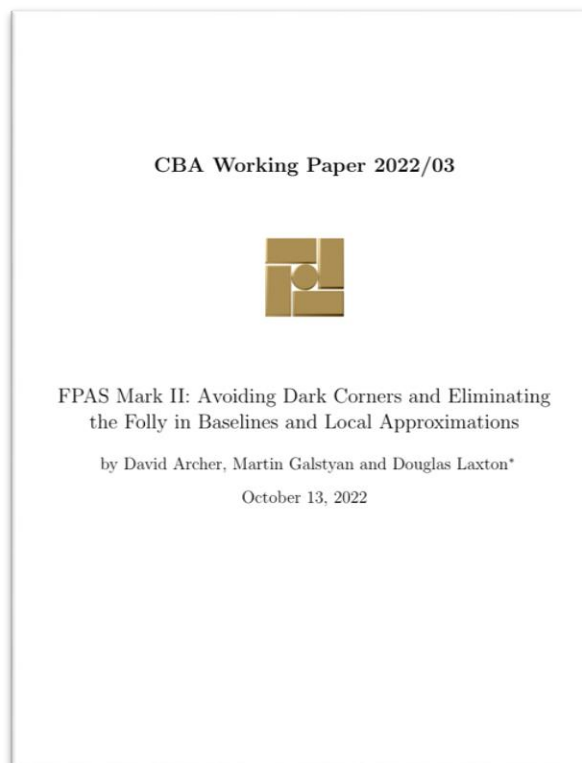
# FPAS Mark II: Prudent Risk Management Approach to Monetary Policy



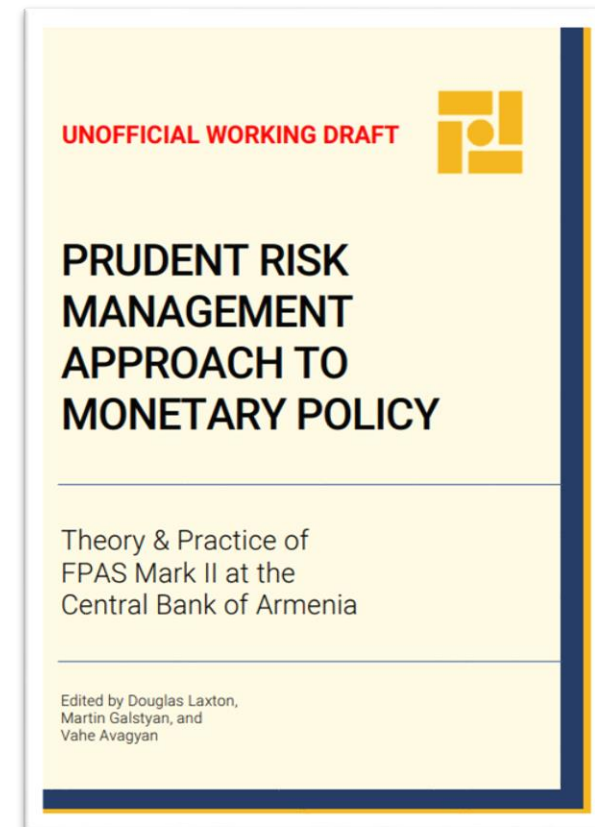
## Governor's Talk: Risk Management Approach to Price Stability: The Role of Policy Credibility



## Working Paper on Key Elements and Principles of FPAS Mark II Framework



## Book on Theory & Practice of Prudent Risk Management Approach to MP at the CBA



# Essential Ingredients of FPAS



Where is the economy now?



What are the underlying forces?



What do policy instruments need to do to achieve policy objectives?

Elevating importance of avoiding dark corners

	Non-FPAS: Japan, UK, etc.	FPAS Mark I: Canada, Czech Republic, etc	FPAS Mark II: Armenia, Georgia
Three ingredients of FPAS	✗	✓	✓
Uncertainty: Scenario Analysis	✗	✗ ✓	✓
“Least Regrets” Policy	✗	✗	✓
Accountability & Transparency	✗	✓	✓

# FX Interventions as an Unconventional Policy Strategy When the Interest Rate is Constrained



	Real GDP Growth	Real Export Growth	Output Gap	CPI Inflation	3-yr Ahead Inflation Expect.	Long-term Interest Rate	Short-term Interest Rate	Bilateral USD Ex. Rate
				<b>CANADA</b>				
<b>2007</b>	2.0	1.1	1.9	2.1	2.1	4.3	4.2	100.0
<b>2008</b>	1.2	-4.5	0.9	2.4	2.1	3.6	2.4	99.3
<b>2009</b>	-2.7	-13.1	-3.5	0.3	2.1	3.2	0.4	106.4
				<b>JAPAN</b>				
<b>2007</b>	2.2	8.7	0.4	0.1	0.9	1.7	0.6	100.0
<b>2008</b>	-1.0	1.4	-1.4	1.4	0.9	1.5	0.4	87.8
<b>2009</b>	-5.5	-24.2	-7.1	-1.3	0.3	1.4	0.1	79.5

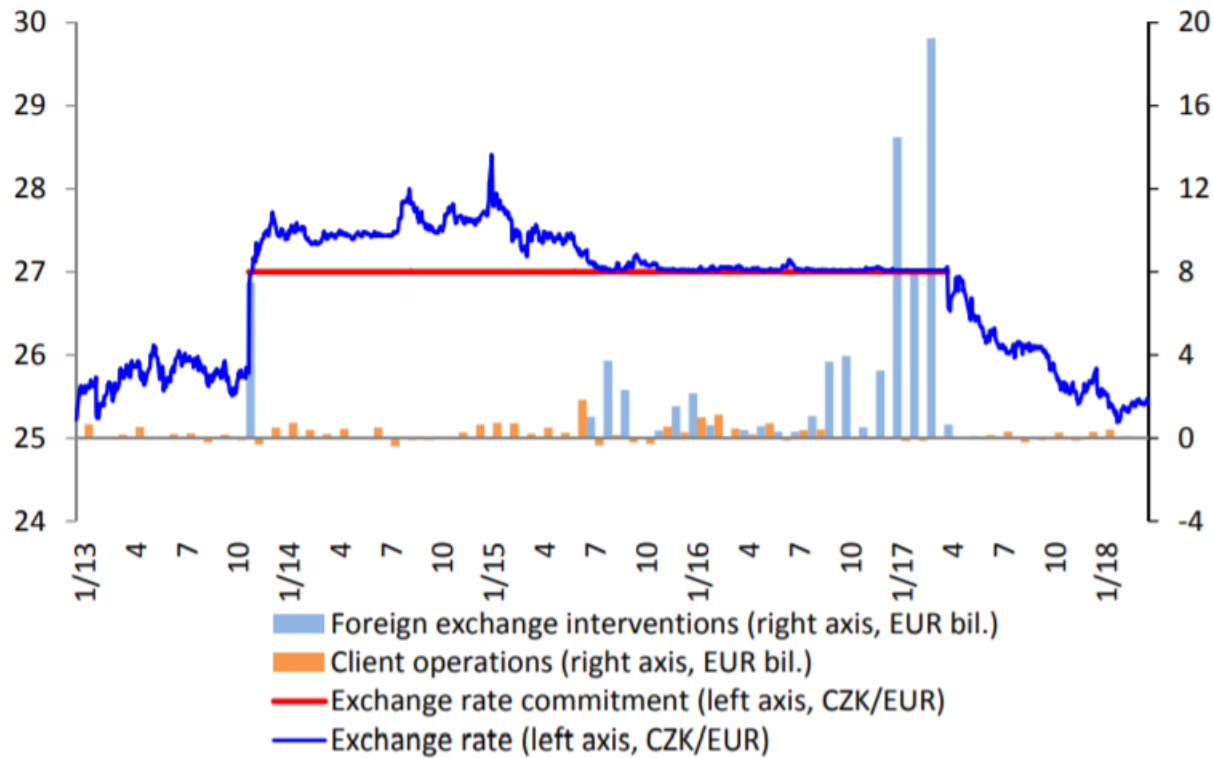
- Exchange rate can act as a shock amplifier when the economy is stuck at the ELB (case of Japan)
- Clear monetary policy strategy can help stabilize the economy out of a deflationary spiral (Canada, Czech Republic)

Source: IMF World Economic Outlook, October 2014

# FX Interventions Strategy to Help Monetary Policy when the Interest Rate is Constrained



## Unconventional MP in the Czech Republic: Exchange Rate as a Tool



Source: Franta, M. T. Holub, B. Saxa, 2018, Balance Sheet Implications of the Czech National Bank's Exchange Rate Commitment, CNB Working Paper Series 10

- Strategic use of FX interventions significantly enhances the central bank's ability to navigate economic challenges when facing low inflation and interest rate constraints
- CBs in small open economies always have the power to depreciate currency, because they can purchase unlimited amount of foreign currency
- If the strategy is credible, CBs may not need any interventions to depreciate the currency

# Framework for FX Interventions under Risk Management Approach

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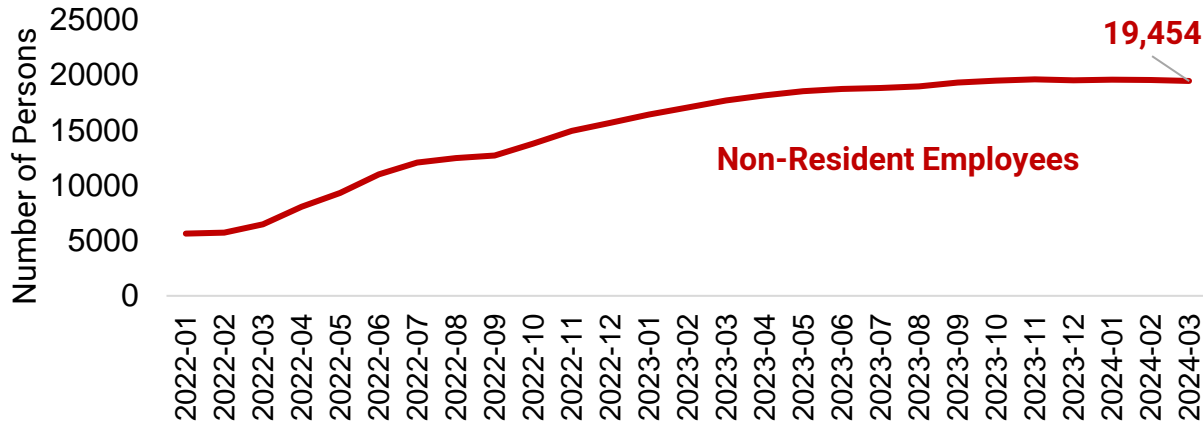


- FPAS Mark II - focuses on nonlinearities and uncertainties to avoid dark corners to ensure price stability
- Exchange rate as an instrument and not a target
  - Need few interventions if the strategy is credible
- Framework with unconventional policy as a part of the analytical framework and effective communication.
- Acknowledging the role of unconventional tools and FX strategy in a framework would signal monetary authorities' commitment to the price stability objective, and minimize costs and uncertainty during implementation.

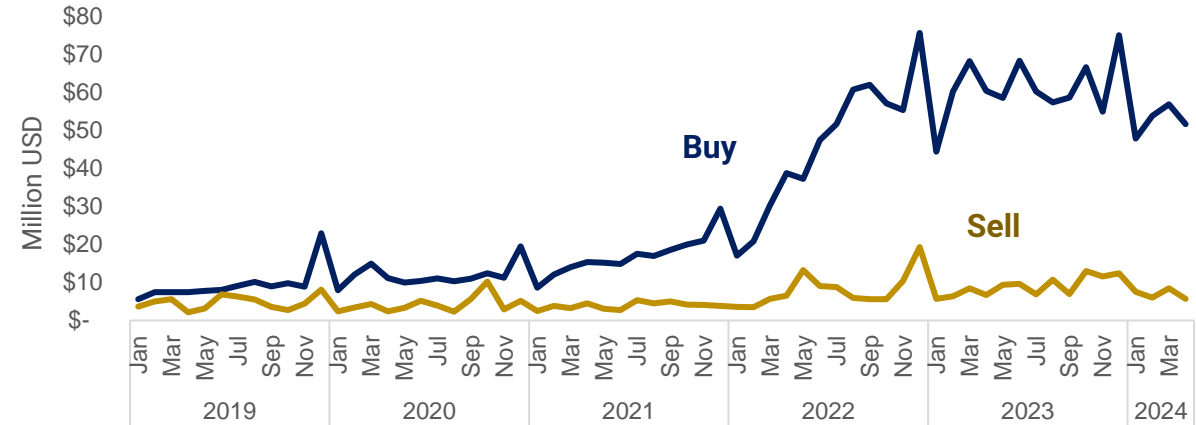
# Significant Inflow of Capital and Labor Led to Substantial Appreciation Pressures in 2022



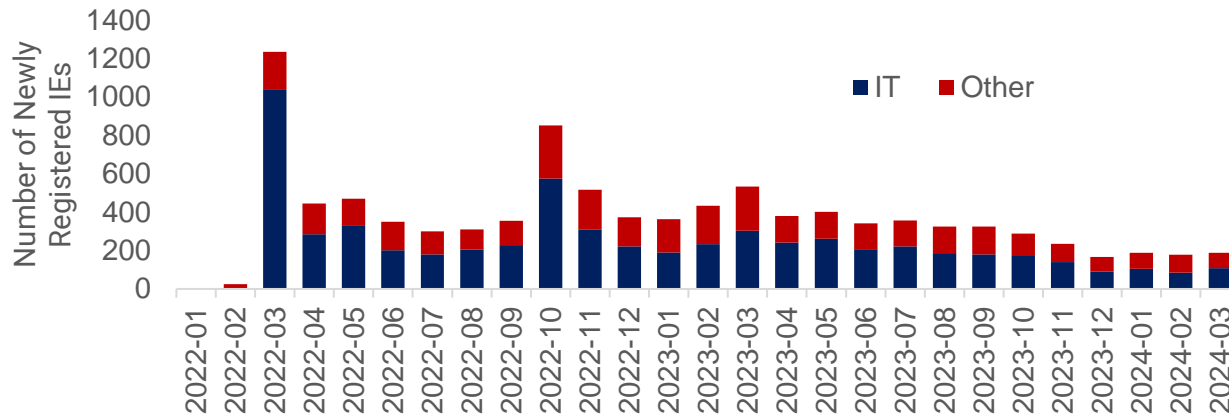
### Number of Registered Non-Resident Employees



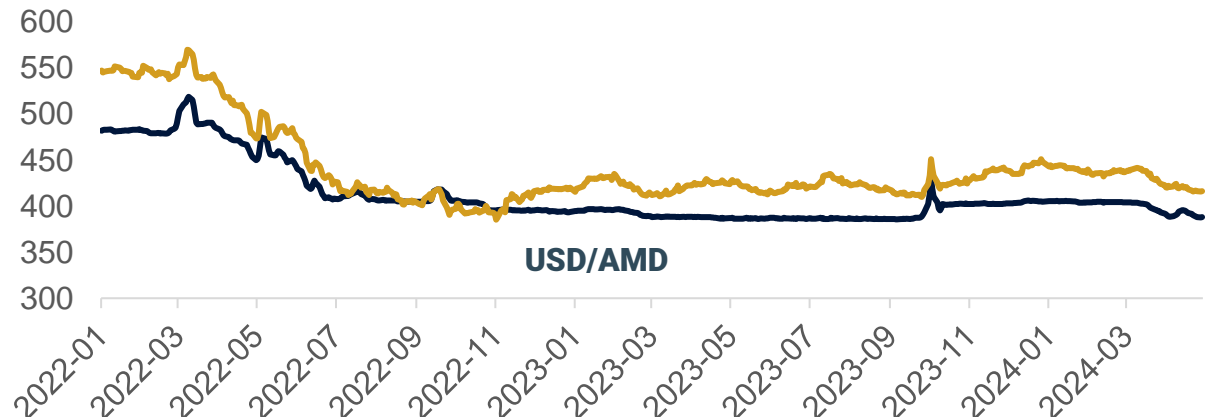
### Currency Transactions by IT Sector, Million USD



### Individual Entrepreneurs Registered by Citizens of Russia, Belarus & Ukraine in the State Register of Legal Entities of Armenia



### Nominal Exchange Rates

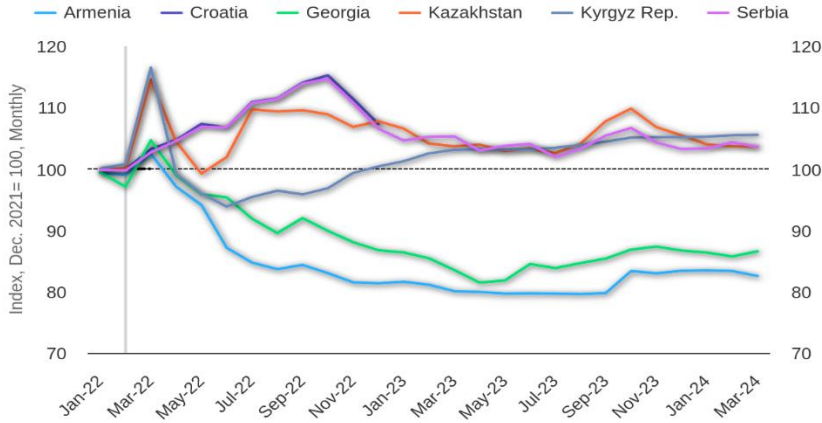


Source: Statistical Committee of the Republic of Armenia; State Revenue Committee; Central Bank of Armenia

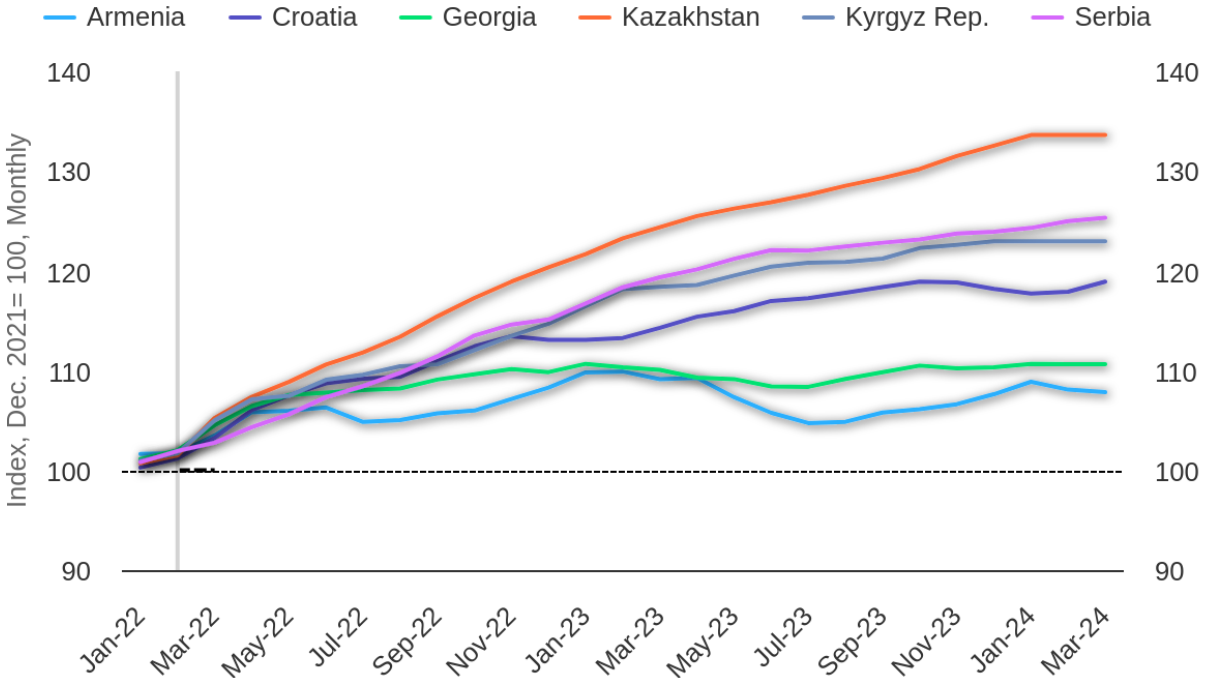
# In the Face of External Demand Shock, Exchange Rate Appreciation Helped to Control and Stabilize Inflation



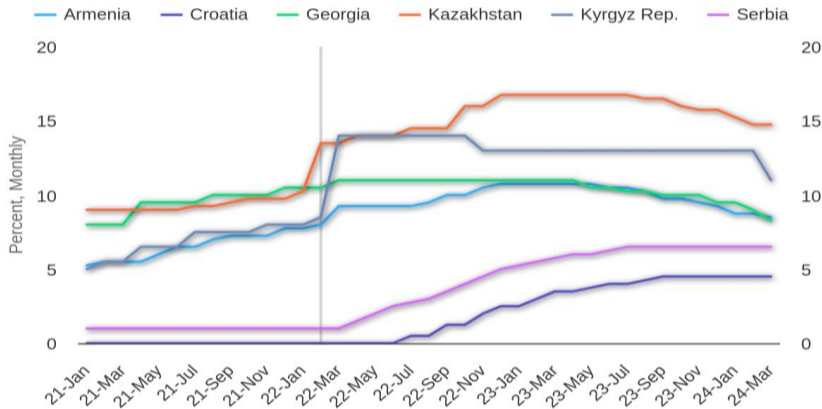
## Exchange Rate



## Headline CPI



## Policy Rate



Source: National central banks and the International Monetary Fund (IMF), Author's Calculations. Note: Exchange Rates are in National Currency Per U.S. Dollar and Increasing indicates depreciation.

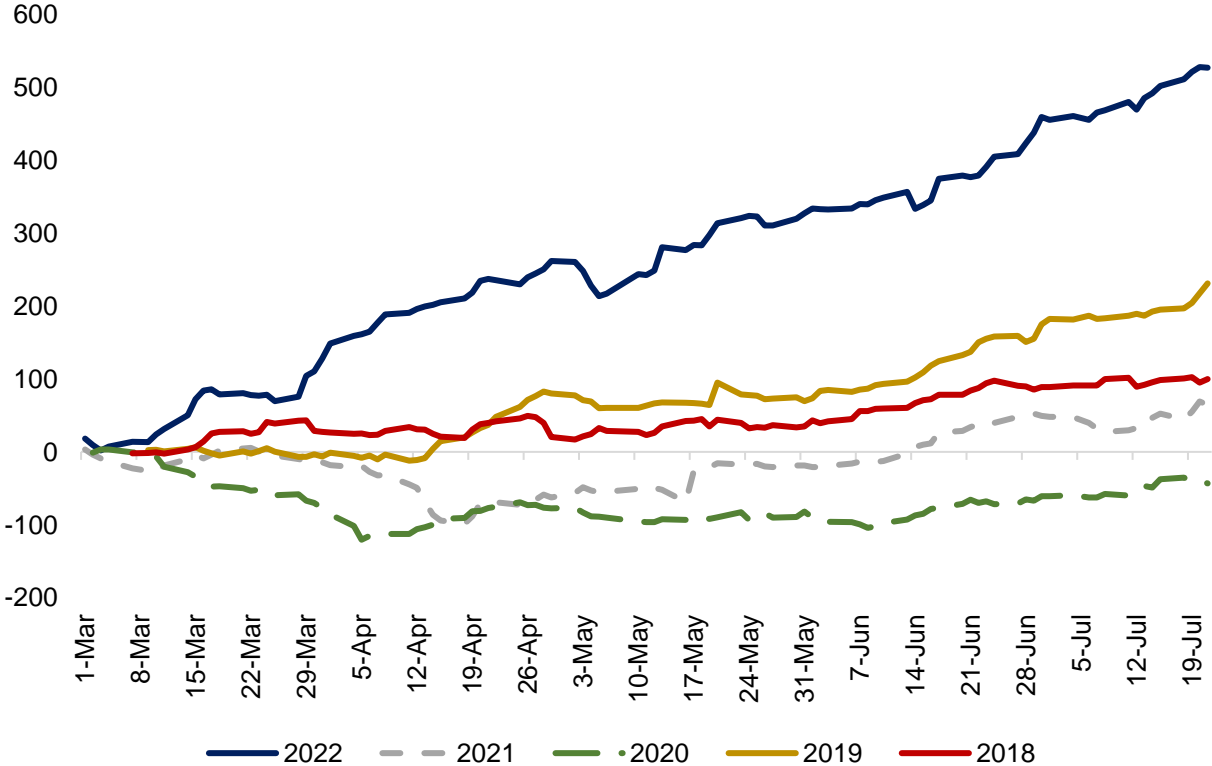


# Second Best Argument for FX Interventions

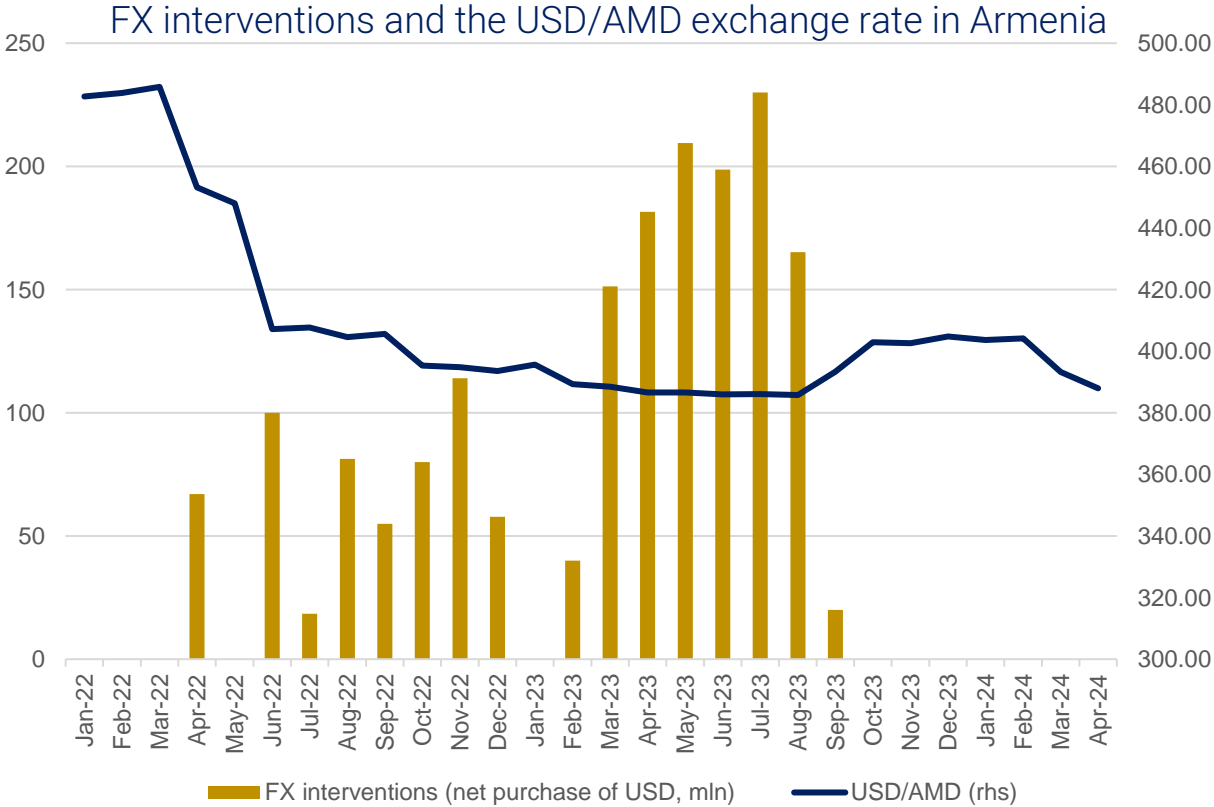


## FX Interventions to Prevent Disorderly Conditions and Ensure Normal Functioning of Financial Markets

Cumulative FX Supply in Different Years (USD & RUB)



In Certain Episodes, FX Conversions were too Much to be Effectively Absorbed by the Market



Source: Central Bank of Armenia

# The Implemented FX Intervention Strategy Ensures...

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- Effectively and transparently communicating combination of MP tools to ensure the price stability objective;
- Not interfering with the fundamental determination of the exchange rate, while recognizing the essential role of the exchange rate for monetary policy transmission;
- Creating sufficient incentives for the private sector to undertake FX risk and manage it, while being ready to intervene to ensure normal functioning of financial markets.



Thank You