

Remittances and exchange rate policy: FAVAR results for Armenia, Kyrgyzstan, Moldova and Tajikistan

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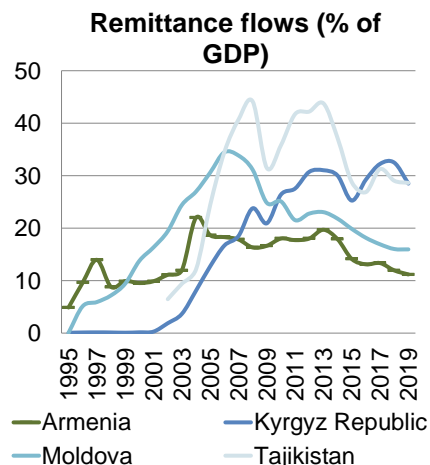
Eurasian Development Bank (EDB)*

*Disclaimer: The view expressed in the study does not reflect the view and the policy of the EDB and its governing bodies

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Facts about remittances to Armenia, Kyrgyzstan, Moldova and Tajikistan

- Remittance flows have experienced a significant increase over the 15 years, but are projected to decline in 2020 due to COVID-19 pandemic
- They are the largest source of foreign exchange earnings, often exceeding export revenues, FDI, aid, or other private capital flows
- Russia is main donor country for remittances to Kyrgyzstan and Tajikistan
- Quality and coverage of data on remittances are still subject to limitations



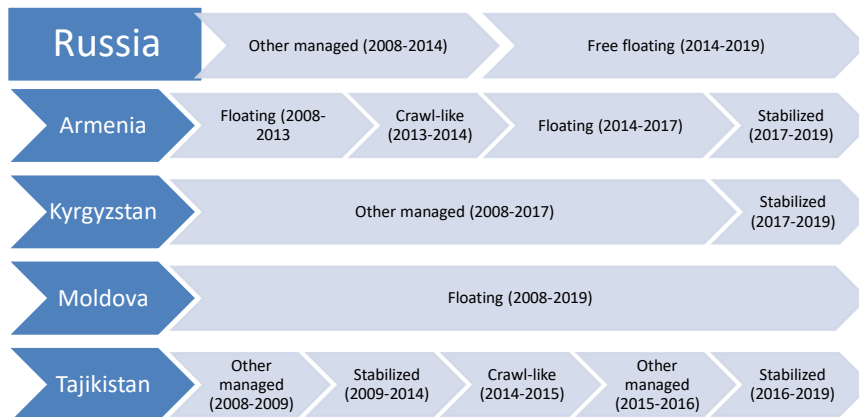
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Links between exchange rate and remittances

- Macroeconomic effect in recipient country: temporary increase inflation, GDP, the domestic money supply and appreciation of the real exchange rate under a fixed regime, but temporary decrease in inflation, increase GDP, appreciation of the real exchange rate and generate no change in the money supply under a flexible regime.
- Do remittances matter for the choice of the exchange rate policy in recipient country?
- Does the change of exchange rate policy in donor country matter for remittances' effect on recipient country economy and exchange rate policy?

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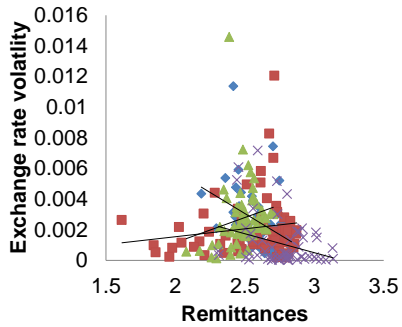
Exchange rate arrangements (IMF classification)



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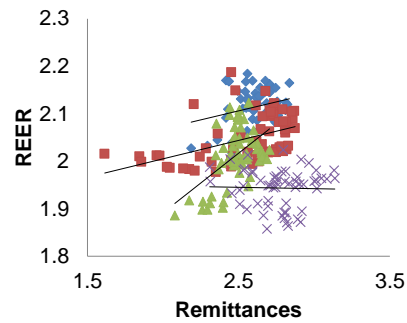
Causality and Linkages

Exchange rate volatility and Remittances



◆ Armenia ■ Kyrgyzstan
▲ Moldova × Tajikistan

Remittances and REER



◆ Armenia ■ Kyrgyzstan
▲ Moldova × Tajikistan

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Factor-Augmented VAR approach (Bernanke et al, 2004)

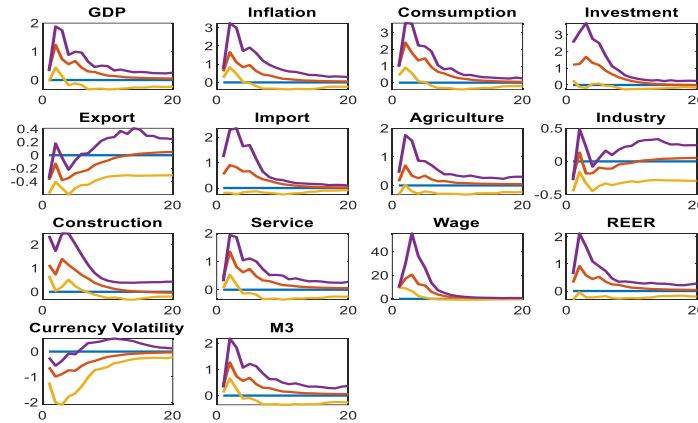
- Step 1:
$$\begin{bmatrix} F_t \\ Y_t \end{bmatrix} = \Phi(L) \begin{bmatrix} F_{t-1} \\ Y_{t-1} \end{bmatrix} + v_t$$

- Step 2:
$$X_t' = \Lambda^f F_t' + \Lambda^y Y_t' + e_t'$$

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Armenia: Dutch Disease and lower exchange rate volatility

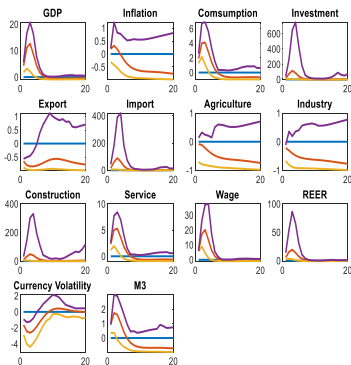
- Remittances have a short-term effect on GDP growth driven by household consumption
- There is a positive response of construction and service sector, as well as wage increase
- Statistically significant reduction of exchange rate volatility



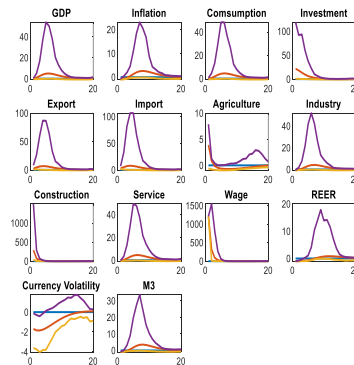
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Armenia: positive shock on remittances leads to a reduced volatility of the exchange rate

Before 2015



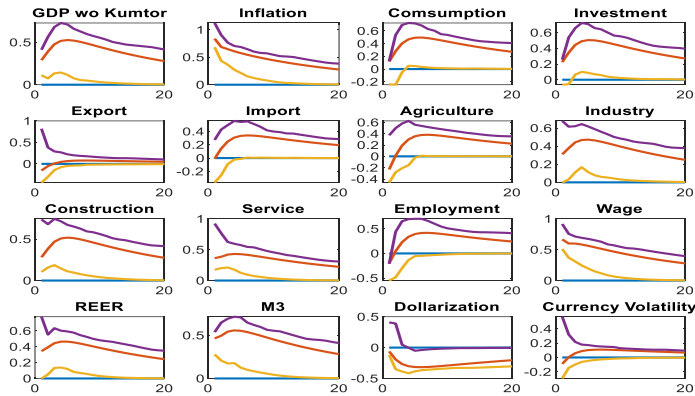
After 2015



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Kyrgyzstan: statistically significant signs of a Dutch Disease

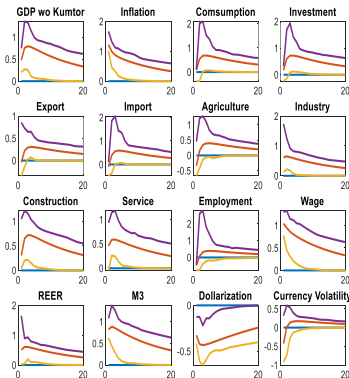
- Remittance shock leads to an increase in GDP by pushing up the non-tradable goods' sector
- Employment in tradable sector decreases, while in non-tradable – goes up
- Inflation increases and REER appreciates



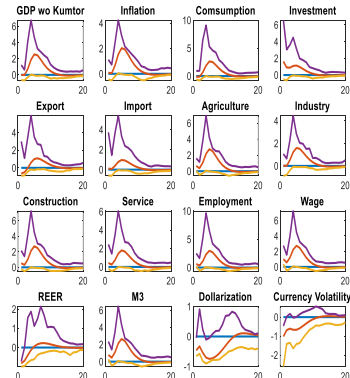
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Kyrgyzstan: positive shock on remittances leads to a reduced volatility of the exchange rate after 2015

Before 2015



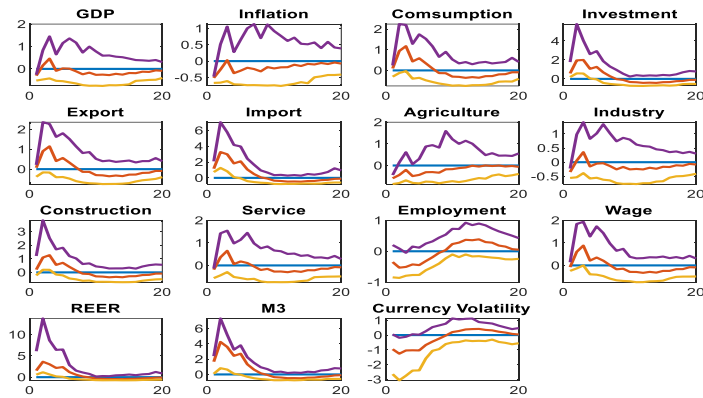
After 2015



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Moldova: no significant sign of Dutch Disease and no effect on currency volatility

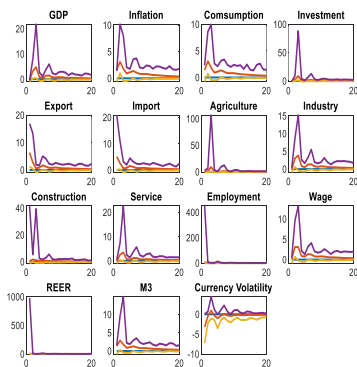
- Positive remittance shock push down the tradable goods' sector
- REER appreciates and no statistically significant effect on exchange rate volatility



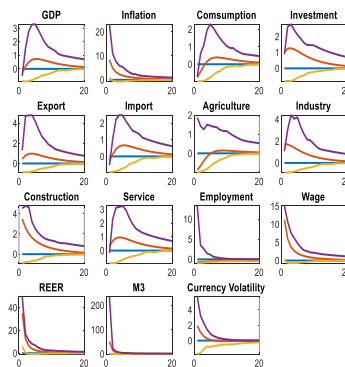
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Moldova: positive shock on remittances does not lead to a reduced volatility of the exchange rate

Before 2015



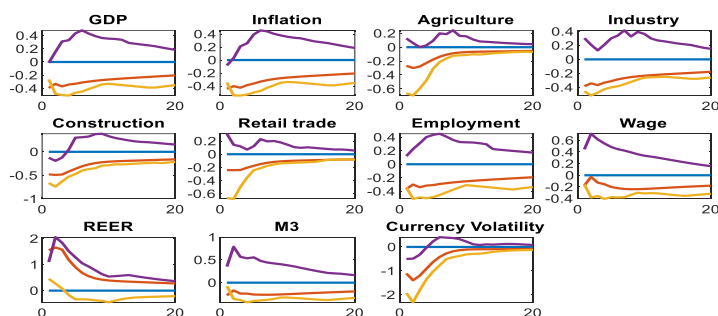
After 2015



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Tajikistan: statistically significant effect on exchange rate

- Remittances lead to a decrease in construction sector by washing out labor resources
- REER appreciates and currency is less volatile



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Preliminary results

- Positive effect of remittances on GDP growth is statistically significant in the case of Dutch Disease effect and reduced exchange rate volatility
- Remittances have considerable contribution to the growth of the service (non-tradable sector), and dampen the agriculture and industrial production (tradable sector)
- Remittance flows influence the growth of real wages and inflation
- In Armenia and Tajikistan remittance positive shock is associated with reduced volatility of the exchange rate. In Kyrgyzstan reduction of exchange rate volatility is observed after 2015. In Moldova – there are no statically significant response of exchange rate policy to the remittance shock

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Thank You!