# DAB MONETARY POLICY – Exchange Rate and Currency Depreciation

***By: Ajmal Ahmady***

Recently the AFN fluctuation has received the media and peoples' attention, requesting an explanation from Da Afghanistan Bank. Although it is perceived as a negative outlook, currency fluctuations are simply a very common occurrence among economies. They happen for a variety of reasons but in our case the depreciation of our currency is mainly caused by deteriorating economic and political situation in Afghanistan.

Let me explain the rate of exchange and how it impacts the economy. Rate of exchange is the value of one country's currency against another country's currency. In simple words, it is the buy and sell of a domestic currency with a foreign currency and in fact one of the key determinants of a nations sound economy. Therefore, fluctuations in any currency impacts country's balance of trade. A higher-valued currency can make the imports cheaper while making its exports expensive at foreign markets and it can have the exact opposite effect for a lower-valued currency.

Please note that Afghanistan has never maintained a fixed exchange rate regime. This means that DAB permits AFN to fluctuate based on demand and supply of domestic and foreign currencies in Exchange Markets. This is very important to note that rise and fall of currencies are due to several determinants, specifically trade relations among countries. Other factors include inflation, interest rate differences, current account deficit, public debt and economic performance. Let us examine some international cases.

A recent example of a major depreciation is the ease of Turkish lira in 2018, when it dropped by 20 percent. There are various reasons for such a sharp depreciation. The first reason being investors fear of Turkish companies' inability to pay loans in dollar and Euro as the lira kept hitting low. Second reason was President Trump's approval of doubled tariffs imposed on Turkey's aluminums and steel industry. Central Bank of the country also prevented an increase in interest rates while not having enough foreign reserves to compete in foreign exchange market. The lira kept depreciating to 26% by 2020 and lost its value more than 50% from 2017. Further extreme examples are depreciation of Iranian Rial and Uzbekistan Som over the past few years.

Therefore, Afghani is not alone to have had a depreciating trend over the years. As stated, currencies fluctuate based on domestic and international economic changes. A six-year trend (shown in the graphs below) show the currencies of the neighboring countries have also depreciated. In another example, the Pakistani Rupees value was at 85 in 2010, devalued to 102 in 2015 and eventually dropping to 161 in 2020 against US dollars.

Now let's analyze the situation of the Afghani in particular. The depreciation in AFN in contrast with other regional currencies have only been four percent during the past years, this is almost negligible considering the aforementioned realities in our horizon. Particularly last 30 days, AFN experienced an accelerated downward trend causing concern among Afghans. While understanding their legitimate concerns, we would also highlight latest security and political developments as the primary cause of contribution. At the same time, inflation has been kept within single digits. We should bear in mind that DAB's core mandate is to keep price stability through developing monetary policies that best contribute to financial stability.

Role of the central banks pertaining to rate of exchange?

Central banks are the main financial authority in most countries. Their role is keeping financial stability by preventing inflation and regulating monetary policy. Central bank decisions on monetary policy are influential in determining exchange rate. The central bank manages the internal economic variables such as exchange rate by altering money supply, interest rates, and by intervening in foreign exchange markets. It will use its domestic and foreign reserves to buy and sell foreign currencies within the foreign exchange market.

DAB does not target exchange rate in the market. However, considering its significant impact on other macroeconomic indicators, it closely monitors exchange rate behavior to smoothen large fluctuations. AFN exchange rate experienced minor fluctuation against major currencies. Since the beginning of 2021, AFN has depreciated by 0.71 percent averaging 77.33 and as of end of May stood at 77.66 per USD. We at the central bank have three tools to implement Monetary Policy Objectives. These tools are used to mop up excess liquidity to keep inflation within pre-defined targets. The constituents are CN Auction, Open Market Operations and Wadiha Auction. Besides worsening security situation, Covid-19 has been another factor to slow down overall economy including trade, private sector, manufacturing and services sector. The third wave took a huge toll on many Afghans both physically and emotionally. In fact, our international partners in the recent meetings, appreciated our stance on major macroeconomic variables including Exchange Rate. IMF's recent review of Extended Credit Facility (ECF) program for Afghanistan was considered successful, making the next disbursement available. The full press release can be read here: IMF Executive Board Completes First Review of the Extended Credit Facility Arrangement for the Islamic Republic of Afghanistan

After completing the assessment, Mr. Mitsuhiro Furusawa, IMF Deputy Managing Director, commended the Afghan partners in IMF's June 7 press release: *"Despite facing formidable challenges, the authorities continued to demonstrate strong program ownership. Going forward, macroeconomic stability, reforms supported by donor grants and capacity development, and accelerating vaccinations will be key to addressing the pandemic's legacies."* on Afghanistan's banking and financial performance.

So what is next for us? While risks in Afghanistan have increased, DAB has sufficient reserves and capabilities to maintain macroeconomic stability in the country. In addition, this quarter DAB made significant achievements in several other areas such as the development of our national payments system. In sum, inflation remains low, macroeconomic situation is stable, and DAB stands ready to support economic growth.

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# Australian 2Q21 inflation overshoots target - no worries

Central Bankers' favourite "T" word, "transitory" will likely be dusted off again after Australia's 3.8%YoY inflation print for the second quarter of 2021. This is up from an inflation rate of only 1.1% in 1Q21. However, almost 2 percentage points of this inflation increase is entirely due to base effects. The CPi index for 2Q 2020 fell by 1.9% from the previous quarter. And of the 0.8%QoQ print for 2Q21, we probably would have anticipated something around the 0.6-0.7% range even in normal times, so this doesn't look at all like what is going on in the US, where the run-rate of CPI really has picked up dramatically, making it more than just a base-driven increase.

Without a monthly release, it is harder to perform an equivalent run-rate analysis for Australia. But it is instructive to look at the trimmed means and weighted median inflation measures to get a similar idea of what is really going on once all the frothy outliers are removed. These measures are certainly reasonable substitutes for annualised run rates. And they show a much more moderate pick up. The trimmed mean CPI inflation rate rose to just 1.6%YoY from 1.1% in 1Q21, thanks to a 0.5%QoQ increase. And a similarly modest quarter-on-quarter increase took the weighted median inflation rate to 1.7% from 1.3%.

So underlying inflation is rising. It just isn't rising very fast. And it still looks quite subdued relative to the RBA's 2-3% longer-term target, which as we all now know, they aren't too worried about exceeding in the short-term.

In terms of the drivers of QoQ inflation, which is a much more meaningful metric than the year-on-year measure when base effects are as large as they are right now, the story has moved on very little from the first quarter. Transportation continues to show a big increase - a combination of retail gasoline prices reflecting higher crude, plus a global shortage of vehicles due to semiconductor shortages keeping prices elevated.

Healthcare costs also remain high, for obvious demand-related reasons. Services are also seeing prices rise a bit faster than elsewhere, which is perhaps more interesting as this could imply faster-rising wages growth. But we'll have to wait and see on that. And besides those components, nothing rose much more than 0.5% on the quarter, with quite a few sectors seeing weak pricing pressure persisting.

We can't see the Reserve Bank of Australia (RBA) being too alarmed by this data. They have made it quite clear that they anticipated a short-lived spike in inflation above the upper bound of their target and were unlikely to be moved by this. In recent months, we have seen the RBA statements on policy change to allow for a more flexible response to growth, inflation and most importantly, labour market developments. And in due course, we suspect that they may concede that a rate hike before 2024 is possible. That is not their current guidance though. And this data won't influence that decision if and when it is eventually made.

The wage price index released on 18 August has a greater potential to influence the official policy stance, and there is another RBA meeting between now and then, which is unlikely to shift guidance meaningfully in the meantime. So a period of "watching and waiting" beckons.

Australian FX and bond yields are more likely to be influenced by external factors in the meantime, as well as the authorities' response to local pandemic problems, rather than by any monetary policy thoughts.

# Britain's economy to recover at post-war record says IMF

Britain is being tipped to see its fastest annual rate of growth since World War Two by the International Monetary Fund.

UK GDP this year will rise by 7%, said the IMF, an upgrade on its forecast of a 5.3% recovery in April and helped by the success of its vaccination programme.

Growth is expected to slow in 2022 to 4.8% or slightly ahead of the EU, which is tipped to grow at 4.3%.

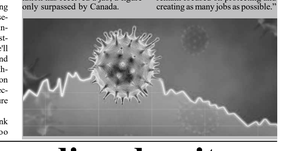
Britain is well-placed to cope with even a super contagious Covid-19 strain said the monetary agency, due to the speed of its vaccination programme..

Around 70% of the UK population has received a jab, a figure only surpassed by Canada.

"In countries with high vaccination coverage, such as the United Kingdom and Canada, the impact would be mild; meanwhile countries lagging in vaccination, such as India and Indonesia, would suffer the most among G20 economies."

Countries that have been slow in vaccinating their population could see growth slow in both 2021 and 2022 if the new variants take hold and higher infection rates cut mobility and activity, the IMF added.

Rishi Sunak, the UK chancellor, said "We still face challenges ahead as a result of the impact of the pandemic, which is why we remain focused on protecting and creating as many jobs as possible."



# FTSE 100 finishes lower as life insurers and base metal miners weigh

The UK market finished Tuesday's trading session lower, led by a decline in shares of life insurers and base metal miners, as global growth concerns continued to rattle equity markets.

The FTSE 100 ended down 29 points, or 0.4%, at 6996.08, having earlier fallen as low as 6929.

"In the UK, we have continued to see case numbers decline, with a week-on-week drop of 21.5% raising confidence in the economic recovery," IG senior market analyst Joshua Mahony wrote.

"That optimism has also led to an impressive outperformance for the domestic UK-focused bus companies, with many hoping that this decline in Covid cases will ensure restrictions can remain at bay as businesses get back to normal," Mahony added.

Notable decliners included Reckitt Benckiser PLC, which has dropped more than 8% after it warned of cost pressures.

The UK market has recovered some of the ground lost earlier as investors fretted about China's growing clampdown on tech companies.

Heading into the close the FTSE 100 is down 28.42 points or 0.4% at 6997.01, having earlier fallen as low as 6929.

Michael Hewson, chief market analyst at CMC Markets UK, said: "The rout in Chinese markets continued today with the Hang Seng sliding to a nine-month low, which in turn has bled into wider market sentiment in Europe today. The weakness seen in Europe today appears to be a by-product of wider fears that a policy misstep from Beijing could have wider consequences for the global economy.

**AFP**

# Economy needs free spending despite 'great concern' over inflation

Consumers, businesses and government need to take "collective responsibility" for spending their way out of the pandemic, a leading economist has said.

Neil Gibson, chief economist for consulting firm EY, told the Irish Independent that spending is necessary despite growing inflation fears.

"If we all keep our money for a rainy day, don't be surprised if there's nothing open. Businesses won't survive if we're not willing to maybe make some compromises - when it's safe to do so."

However, he said inflation is of "great concern" even though central bankers insist that recent price hikes are temporary.

"The accepted wisdom is that it's a step, and that we will be through and back to normality quite quickly on prices.

"I think that we need to be realistic. There are enough conditions out there to say it could be something a little bit more challenging than that."

A combination of rising wages, commodity prices and house prices could put governments in a difficult position next year, he said.

"I'm not saying that means policymakers should be doing anything too significant at this point - worrying about interest rates at the European level or maybe starting to think of cutting back spending and austerity - but don't ignore it. Don't just assume that it's going to go away."

Eurozone inflation tipped the European Central Bank's 2pc target in May before falling slightly to 1.9pc in June.

The ECB indicated last week that it wouldn't be increasing interest rates - one of the main ways to curb spending - or paring back its pandemic bond buying any time soon.

Meanwhile, Mr Gibson said government spending may need to be met with higher taxes, including a potential 15pc minimum tax rate for large multinationals.

"If we end up in the 15[pc] space, that doesn't send alarm bells ringing about Ireland's competitiveness as a location. It's still the lowest rate amongst the competitor nations.

"The bigger question is, will be able to make good on our public sector commitments and demands from our citizens with the tax take that we have currently? And I think, even for an economy growing as fast as Ireland, that looks like a challenge."

He spoke to the Irish Independent after a business webinar hosted by the Association of Chartered Certified Accountants (ACCA) this week.