

"The pass-through to consumer prices in CIS economies: The role of exchange rates, commodities and other common factors"

Mariarosaria Comunale
Bank of Lithuania

Heli Simola
Bank of Finland

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Non-technical summary

The Commonwealth of Independent States (CIS) countries, a group of twelve former Soviet republics, have received little attention in studies of exchange rate pass-through (ERPT), despite adequate available data (at least for Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Russia, and Ukraine) to make them research subjects. Only a handful of studies note the importance of the ERPT in CIS inflation trends, and none provide cross-country ERPT analyses. Given that some CIS countries recently shifted to inflation targeting in their monetary policy (Armenia in 2008, Georgia in 2010 and Russia in 2014), and several more are planning the shift, policymakers stand to benefit from an improved understanding of the magnitude and timing of effects on prices from exchange rate changes.

This empirical study considers the pass-through of key nominal exchange rates and commodity prices to consumer prices in the CIS countries, taking into account the effect of idiosyncratic and other common factors influencing inflation. In order to do that given the relatively short window of available quarterly observations (1999–2014), we choose heterogeneous panel frameworks and control for cross-sectional dependence. Indeed, due to their geographic proximity, strong economic links and institutional legacies, global factors and spillover effects can play a significant role in CIS ERPTs. For instance, all are highly vulnerable to changes in global commodity prices and may be affected by international crises in various ways.

Recent developments in the CIS countries include episodes of strong devaluation, so we also examine for possible asymmetries related to ERPT. As there is currently no similar research in a cross-country setting for the CIS countries, our results provide novel insights into this issue.

We find that exchange rate pass-through is still relatively high and rapid in the CIS countries. When the nominal effective exchange rate index declines by one per cent, the consumer price index increases by 0.12–0.13 per cent over the next quarter. This effect is quite robust across a variety of specifications and time periods. The pass-through effect roughly doubles after two quarters, and rises to about 0.50 per cent after four quarters. Common factors, including spillovers, and the financial gap also seem to be important in consumer price trends of the CIS countries. Finally, we present evidence of an asymmetrical effect in case of exchange rate *vis-à-vis* the US dollar; in the case of large rate swings, this exchange rate pass-through becomes significant and similar to that of the nominal effective exchange rate.

From the policy point of view, our results confirm that ERPT is still an important factor for price development in the CIS countries and should be taken into account when evaluating the inflation outlook, together with commodity prices, financial gap, global factors and spillovers.