

Keynotes of NBK Deputy Governor Aliya Moldabekova About Situation on Currency Market in June 2021 – Ambiguous Dynamics on Global Financial Markets and KZT limited appreciation

Dynamics of global financial markets remain ambiguous. On the one hand, improved forecasts of global GDP growth and ongoing vaccination pace support prices for risky assets. On the other, hawkish Fed rhetoric supports USD and negatively affects currencies of emerging countries.

Regarding events which affected behavior of global financial markets last month

Low rates and fiscal stimulus continue to have a global impact on inflation amid accelerated economic recovery, outpacing growth in deferred demand and a slow recovery in supply chains.

In this regard, an increase in pro-inflationary pressures in both developed and emerging countries is observed. For example, in the US, May inflation rose to its peak in 13 years - 5.0%, in the EU - up to 2.3% (maximum since November 2018), in Russia - up to 6.5% (maximum since September 2016).

Stronger inflationary expectations led to a rhetoric of more tight monetary policy or direct reinforcement of the tight monetary policy of the world's central banks. In June, a number of central banks of the emerging market raised their base rates: Central Bank of Brazil increased it up to 4.25% (+75 bps), Central Bank of Mexico up to 4.25 (+ 25 bps), Central Bank of the Russian Federation up to 5.5 % (+50 bps). A further increase in the rate of the Central Bank of the Russian Federation is expected from 25 to 100 bps in July this year

Key event of the month was a meeting of the US Federal Reserve System on June 16. The regulator put on hold the range of the key rate between 0 and 0.25%. However, members of the Fed Board of Governors raised a median forecast for the key rate, expecting two increases by the end of 2023. Moreover, it was reported that the discussion was initiated about tapering the "asset purchase" program.

Along with that, it should be noted that rhetoric of individual Fed representatives is also ambiguous. During June we witnessed mixed comments from different representatives of the regulator. For example, J.Bullard believes that the rate increase will start in late 2022, while J.Williams commented that the increase in the key rate is still 'far in the future.'

Change in the rhetoric of the US Fed has driven USD rally, DXY - USD index against a basket of currencies of developed countries went up by 2.9%. In turn, this affected attractiveness of emerging markets and negatively affected dynamics of the EM currencies: South African rand lost 4% of its value, Turkish lira - 2.6%, Indian rupee - 2.4%, Indonesian rupee - 1.5%.

Therefore, behavior of the global financial markets remains ambiguous. On the one hand, improved forecasts for global GDP growth and ongoing vaccination pace support prices for risky assets, and on the other hand, growth of inflationary expectations worldwide and speed of spread of new Delta variant of Covid-19 increase risks of further restrained recovery of the global economy.

About situation on the oil market

As the global economy continues its recovery, expectations for increased demand for energy resources have maintained rally in the oil market. As a result, in June price for Brent crude oil rose by 8.4% up to to US\$ 75.13 per barrel.

Timeframe for return of the Iranian oil to the global market, which I talked about in a previous interview, remains doubtful. At the moment, negotiations on the deal have been postponed due to ongoing disagreements between the parties. Therefore, this factor has less impact on global oil prices.

In early July, growth of oil prices accelerated after cancellation of the third round of OPEC + negotiations about further fate of the deal to limit output, as a result of which price for Brent crude surpassed US\$ 77 per barrel for the first time since 30 October 2018. The previous two meetings have failed due to a different position of the UAE on the terms and conditions of extension of the deal until late 2022.

However, reports about negotiations between the White House administration with Saudi Arabia and the UAE in hopes to reach an agreement to contain price growth, as well as heightened concerns about speed of spread of Delta strains of Coronavirus and introduction of new quarantine restrictions influenced adjustment of oil prices to levels of US\$ 73-74 per barrel.

Current oil prices are at US\$ 75 per barrel amid declining US oil reserves and growing sale prices from Saudi Arabia by an average of 80 cents per barrel. In general, there is a lot of uncertainty on the oil market, which is exacerbated by concerns about struggle of OPEC + participants for a market share with a failure to reach an agreement. Moreover, the situation is aggravated by risks of further deterioration of the situation associated with the Delta variant, which also has a significant impact on the current dynamics and volatility of the oil market.

About situation in the domestic market and about expert opinions concerning ‘faults in enhancement’ of KZT against the background of current oil prices

Indeed, in June, KZT moderately gained 0.9% at the close on June 30 to 424.95 KZT for USD, while the oil price rose by 8.4% month-on-month. Oil remains a main factor that affects the national currency exchange rate. Insufficient response of KZT to positive oil dynamics is explained by fact that KZT exchange rate was exposed to a combination of negative factors, including both external and internal ones.

I have already mentioned general negative dynamics of emerging market currencies during the month and rally in the USD exchange rate in the global foreign exchange market.

And if we talk about internal factors that put pressure on KZT in June, then, first of all, we should point out growing imports of goods in conditions of recovery in business activity and due to a deferred demand. We have already mentioned that in January-April 2021 imports expanded by 11.5% year-on-year up to US\$ 11.4 billion due to growing imports of consumer non-food products and capital goods.

Increase in demand for foreign exchange can be clearly seen from the increase in the trading volume. USDKZT exchange trade volumes in June grew to US\$ 3.16 billion, while an average monthly trading volume for the first five months of 2021 made US\$ 2.45 billion.

Growing demand for foreign exchange is also attributed to seasonal factors such as dividend payments to foreign investors. Last year, amid the crisis, dividend payments were very limited, this year this factor is significant in terms of demand in the foreign exchange market in May and June. All of the above-mentioned factors have limited further appreciation of the national currency.

Despite elevated demand for foreign currency, there were no significant imbalances in the market, and the National Bank did not intervene. Volume of conversions of the National Fund's funds for transfers to the budget amounted to US\$ 1093 million, and sale of foreign currency by the quasi-public sector totaled US\$ 260 million.

About dynamics of international reserves in June 2021

According to preliminary data, gold and foreign exchange reserves as of 30 June 2021 amounted to nearly US\$ 35.1 billion and decreased by US\$ 1.4 billion for a month.

The main reason for the fall in gold reserves was a decline in gold price due to global USD rally. Price for the metal fell in June from US\$ 1,892 down to US\$ 1,758 per an ounce or 7% down, which is the steepest drop in gold value in a month since November 2015. As a result, negative revaluation of the gold portfolio amounted to US\$ 1.4 billion.

Gold accounts for 62% of the reserves, therefore reserves are exposed to impact of global gold prices. Gold prices remain volatile, for example, in March, prices reached US\$ 1,683 per troy ounce, recovering to US\$ 1,950 in early May.

Due to the exercise of options previously entered into by the National Bank to hedge part of the gold portfolio from a sharp decline in its price, gold was sold for an amount of US\$ 1.5 billion at a favorable price exceeding current levels.

FX assets rose by US\$ 1.5 billion mainly due to sale of unallocated gold under option strategies.

About dynamics of currency assets of the National Fund in June, investment income and factors of influence on dynamics of the National Fund

Assets of the National Fund in June, according to updated data, totaled US\$ 57.5 billion, decreasing by US\$ 1.1 billion for a month.

Decline in the assets of the National Fund for the past month is associated with allocation of guaranteed and targeted transfers to the republican budget. As I have already mentioned, foreign currency assets in the amount of US\$ 1.093 billion were sold to perform transfer orders.

Along with that, inflows to the fund in June amounted to 97 billion KZT, including US\$ 189 million in foreign currency.

As part of a long-term strategy to improve efficiency of asset management, the National Bank is building up a share of more profitable asset classes, including stocks, corporate bonds and Eurobonds of emerging markets.

As a result, investment income of the National Fund for the first half of 2021 was positive and totaled US\$ 1.5 billion or 2.5%, mainly due to widening of the global stock market.

About key factors and events that can affect KZT dynamics in the near future, about forecasts for development of the global economy

I would point out three key factors that will affect KZT behavior.

First, it is a price for oil - a main export commodity and a factor that determines supply in the domestic foreign exchange market. The oil market, as mentioned earlier, remains volatile, as OPEC + members failed to agree on an increase in production and an extension of the deal after April 2022. According to a majority of experts, the negotiations will continue, and the alliance will nevertheless find a compromise solution.

Second, it is the general market sentiment for currencies of emerging countries. Investor appetite for emerging countries will be formed, in our opinion, based on development of the situation with the Coronavirus and further actions to reduce monetary stimulus of the US Federal Reserve System.

In emerging countries, from Brazil to Russia, Indonesia and Japan, more outbreaks of COVID-19 associated with spread of more aggressive Delta strain are reported. Vaccine exports from the EU and the US will demonstrate a marked growth in the coming months as required vaccination levels are achieved in these countries, which could be a key factor for emerging markets. Growth in global vaccine supply will allow emerging countries to achieve critical levels of protection in the second half of 2021, which could support growing attractiveness of Emerging Markets assets.

Along with that, signals from the US Fed about potential tightening of monetary policy, depending on macroeconomic indicators, would lead to USD growth. Probable reduction in a monthly volume of asset repurchases, according to experts, will cause an increase in rates in the United States and an outflow of capital from emerging countries.

Third, these are internal factors. Ongoing recovery in economic activities and fiscal stimulus will sustain a demand for foreign currency. Business activity index in Kazakhstan remains in a growth zone. In June this year, the index inched up to 51.6 from 51.1 in May this year thanks to the ongoing recovery in industry to 50.4 from 49.6, in services sector to 52.7 from 52.3, and construction to 47.6 from 47.5.

In general, despite the fact that instability and ambiguity of prospects in the global financial markets persist, updated forecasts of the world financial organizations are quite optimistic. Thus, in June this year, the World Bank and the European Bank for Reconstruction and Development released updated forecasts where they revised upward their forecasts for global economic growth for 2021: the World Bank from 4.1% to 5.6%, the EBRD in regions of its presence - from 3.6 % to 4.2%.

The National Bank is also positively views the growth prospects of the global economy, expecting a faster increase in global GDP in the second half of 2021 due to opening of countries and resumption of economic activities after waves of Covid-19 and quarantine restrictions in Europe and India during the second quarter of this year.