The Increase in the Base Rate Supports Conditions for Further Strengthening of Tenge

Deputy Governor of the National Bank Aliya Moldabekova commented on the overview of current trends in the energy market and the impact of change in the base rate on the tenge exchange rate.

- What is a reason behind strengthening of tenge, which we have been observing since last week?

- the exchange rate of tenge at today's opening of trading fluctuates within the range of 424.00-424.70 tenge per dollar, having strengthened by 0.26% since Monday's close and by 0.65% since the beginning of last week. The exchange rate of the national currency for the first time since March broke through the psychological level and consolidated below 425 tenge per dollar. The dynamics of the exchange rate reflects current trends in the energy market.

After a two-week period of volatility, the situation on foreign markets has significantly improved. Brent crude oil price has increased by 9.2% since last week, again exceeding the level of $75 per barrel. The main factor underlying the price increase is the expectation of further growth in energy demand, despite concerns about a new outbreak of COVID-19. Also, most market participants believe that even taking into account the decision of OPEC+ to increase production by 400 thousand barrels per day per month from August of this year, the oil supply will remain limited for the time being.

The US stock market has fully recovered from the fall in mid-July, caused by fears of a slowdown in the global recovery due to an increase in cases of infection with the delta strain of coronavirus and expectations of an early tapering of monetary accommodation. A strong start to the corporate earnings season confirmed the positive expectations of investors for profit growth, which contributed to the renewal of historical highs of stock indices. The improvement in investor sentiment contributed to a slight weakening of the US dollar and an increase in the attractiveness of emerging market currencies.

How will the decision to raise the base rate affect the dynamics of the tenge and the state of the foreign exchange market as a whole?

Yesterday, at the next meeting of the Monetary Policy Committee of the National Bank, it was decided to raise the base rate by 25 bps. to 9.25% per annum. This increase in the base rate is the first change since July last year and, first of all, is justified by the acceleration of inflation. In June, the annual consumer price index in Kazakhstan increased by 0.7% to 7.9%, which is the highest level since January 2017.

The increase in the base rate contributes to the balance of the domestic foreign exchange market by increasing the attractiveness of tenge and tenge assets. In my previous interviews, I noted some imbalances in the foreign exchange market and insufficient strengthening of the tenge due to the growth of imports of goods against the background of the recovery of business activity and pent-up demand. A higher rate on tenge will stimulate the increase of the sales of foreign currency from non-residents, as well as support the internal trend of de-dollarization of deposits.

Also, taking into account the increase in rates on the global market, a more attractive rate on tenge supports a positive differential of rates against other currencies. So, for example, the differential of the rates of the National Bank and the Bank of Russia is 2.75%, and with the federal funds rate of the US Federal Reserve – 9.00%.

I would like to note that since the beginning of the year, we have seen an active influx of foreign investors into domestic government securities. This trend continues, and, according to preliminary data, the current volume of investments of non-residents in the State Securities of the Republic of Kazakhstan is about 800 billion tenge, whereas at the beginning of this year the volume of investments of non-residents was 430 billion tenge.

The decision to raise the base rate will help maintain the balance in the domestic foreign exchange market and maintain the attractiveness of tenge assets for foreign investors. This, in turn, creates conditions for further strengthening of the national currency.