

**Keynotes of NBK Deputy
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Concerning Situation on Foreign Exchange Market in July 2021 – Concerning
‘Delta Risk’ on Financial Markets**

Progressive pace of the spread of the delta strain worldwide has demonstrated that outlook for the global economy is not as optimistic as it seemed a month ago. The situation with the pandemic and rhetoric of the US Fed amid global acceleration of inflation remain key driving forces of the global financial markets.

Concerning events that affected dynamics of the global financial markets in the past month

In July, spread of the delta strain and concerns about its impact on a pace of the global economic recovery significantly intensified. Against the background of a record high increase in new registered cases of Covid-19 in Southeast Asia (Indonesia, the Philippines, Malaysia), Australia, and the UK, new quarantine restrictions were introduced. As a result, economic data signals the first signs of a slowdown in business activity in the Asian regions that have become an epicenter of delta-strain outbreaks, with manufacturing PMI declining last month in Indonesia (down to 40.1 from 53.5), Thailand (down to 48.7 from 49.5), Philippines (down to 50.4 from 50.8), South Korea (down to 53 from 53.9).

Worsening epidemiological situation due to the spread of a new virus mutation put pressure on risk sentiment of investors, reducing their willingness to take risks. First of all, this had a negative impact on dynamics of assets in emerging markets: in July, we witnessed a moderate global strengthening of the US dollar against currencies of emerging countries. The US dollar index against the EM currencies strengthened by almost 1%.

In conditions of a declining interest of investors in emerging markets, EM equities also came under pressure. Thus, by late July, MSCI index of EM equities fell by 7.04%, while index of equities for developed countries rose by 1.72%.

The rhetoric of the US Fed is currently the second key driver for financial markets: comments of the Chairman Jerome Powell at the last meeting on July 28 were taken by investors as a signal for expected tapering of easing programs and start of the tightening of monetary policy.

Concerning situation on the oil market in July

Situation on the oil market as well as on the global foreign exchange market during July was ambiguous and volatile. Oil prices rose and fell following the news about agreements of the OPEC+ countries and the dynamics of the spread of the delta strain of coronavirus. By the end of the month, oil rose by 1.6% to USD 76.33 per barrel.

Meeting of the OPEC+ countries scheduled for early July ended in vain due to contradictions. The countries were able to come to an agreement only by the middle of the month. Members of the alliance reached an agreement on July 18 and

decided to increase production by 0.4 million barrels per day monthly starting from August 2021.

By the end of the month, investors focused on a possibility of a significant recovery in fuel demand due to declining weekly crude oil inventory data in the United States, as a result of which prices rose to levels above USD 76 per barrel.

Higher spread of the delta strain of Covid-19 has exerted its significant negative influence on oil prices since the beginning of August this year: prices dropped by 8.4% reaching USD 69.9 per barrel.

Concerning dynamics of the KZT exchange rate last month

In July, the national currency of Kazakhstan moderately gained 0.7% of its value reaching 424.45 against the background of growing oil prices and the decision taken by the Monetary Policy Committee to raise the base rate by 0.25% to 9.25% p.a. with an interest rate corridor of + / - 1.00 p.p. Increased rate is an extra factor that contributes to maintaining the balance in the domestic foreign exchange market and maintaining appeal of tenge assets for external investors.

Despite a slight decrease in a volume of KZT/ USD trading on the currency exchange in July down to USD 3.09 billion compared to USD 3.16 billion in June, an average daily trading volume remains significantly higher than the average since early 2021: USD 155 million, up from USD 129 million for a period between January and June. This testifies to persistence of a fairly high demand for foreign currency.

As I have already mentioned in my previous interviews, foreign exchange demand is driven by ongoing recovery in the economic activity and growing imports, first of all of consumer goods. Thus, imports of goods in the first half of this year grew by 9.2% and reached USD 17.5 billion. Imports of consumer goods soared by 27%, or USD 1.2 billion, where imports of non-food products surged by 36.0%, or USD 1.1 billion.

Moreover, there is a seasonal factor in demand from individuals due to summer holidays and vacations. According to recent available data, purchases of foreign currency in cash at exchange offices rose from USD 368 million in May to USD 555 million in June.

Nevertheless, foreign exchange market was characterized by supply and demand balance. The National Bank did not make any currency interventions. Volume of conversions of funds of the National Fund to make transfers to the budget totaled USD 1.1 billion, and sale of foreign currency by the quasi-public sector amounted to USD 479 million.

Volume of portfolio investments of foreign investors in government securities of Kazakhstan in July rose from 791 billion KZT to 822 billion KZT, which indicates continued interest of non-residents in tenge assets.

Since early August, tenge has lost 0.3% of its value making 425.53 KZT per USD against the background of spreading delta strain and falling oil prices.

Concerning dynamics of gold and foreign exchange reserves of the National Bank of the Republic of Kazakhstan in July

Preliminary data demonstrate that gold and foreign exchange reserves as of July 30, 2021 totaled USD 35.0 billion with a slight contraction of USD 76 million for the month.

Shrinkage of the reserves followed to a decrease in assets in hard currency. Key reasons behind the decline included a USD 655 million reduction of funds of second-tier banks at the National Bank due to customer outflows and a USD 126 million repayment of the government debt.

On the other hand, growth of the gold portfolio made it possible to almost completely offset the decline in hard currency assets. Against the background of a difficult situation with worldwide suppression of the coronavirus and uncertain prospects for global development economy, gold price in July rose by 4%, to USD 1,828 per ounce, and the gold portfolio in the gold and foreign exchange assets of the National Bank grew by USD 959 million.

Concerning factors that affected volume of foreign exchange assets of the National Fund

According to updated data at the end of July, currency assets of the National Fund totaled USD 56.9 billion, shrinking by USD 450 million over the month.

Contraction of currency assets of the National Fund for the past month was largely attributed to allocation of a guaranteed and targeted transfer to the central government budget for a total amount of nearly 477 billion KZT.

At the same time, receipts to the Fund in July amounted to 40 billion KZT, including 65 million US dollars - receipts in foreign currency.

Last month saw favorable condition of the global markets. Thus, in conditions of growing bonds, shares and gold price, investment income of the National Fund in July made USD 590 million.

Since the beginning of the year, investment income of the National Fund has amounted to around USD 2 billion, or 3.5%. Key driving force of positive investment income is positive returns in the stock market. The National Bank within its strategy to improve efficiency of management of the National Fund increased weights of high return asset classes. Along with equities, the weights of corporate bonds and Eurobonds of emerging markets were increased.

Concerning forecasts of factors that can affect the national currency in the near future and influence of delta strain on these forecasts

Spreading delta strain of coronavirus is a major risk factor and it can entail assessment of economic growth expectations. We are already witnessing a correction in financial markets against the background of the delta wave of coronavirus.

This first of all applies to emerging markets. On July 27, 2021 the IMF has already revised its forecast for global GDP keeping it at 6% in 2021. But as part of this revision, outlook for emerging countries was cut by 0.4 percentage points to 6.3%, with growth in developed countries rising by 0.5 percentage points to 5.6%.

As earlier, KZT will be exposed to influence of the hydrocarbon markets and general sentiment towards assets of emerging countries.

The oil market is experiencing turbulence after almost a 20% surge in prices from April to July 2021. Despite the decline in weekly crude oil inventories in the United States down to the January 2020 levels, spread of the delta strain will hinder further oil growth.

Balancing factor for the local foreign exchange market is a positive differential of KZT rates compared to other currencies. Recent decision of the National Bank to raise the base rate supports appeal of tenge assets for international investors, inflow of which since the beginning of this year totaled 392 billion KZT.

Moreover, as a result of joint efforts of the National Bank and the Ministry of Finance to build a yield curve and improve liquidity of the market of Kazakhstan's government securities, an index management team from JP Morgan reported that Kazakhstan's debt market was added to the so-called 'under the radar list' for a potential inclusion of our government securities into the Government Bond Index-Emerging Markets Global. We will continue to work on globalization of tenge and assets in the national currency.

On August 11, 2021, international rating agency Moody's upgraded the sovereign rating of Kazakhstan in national and foreign currencies to Baa2 from Baa3, stable outlook. This measure was an important positive event for the domestic foreign exchange market. Moody's indicates policy of the National Bank on inflation targeting and a floating exchange rate regime, which supports macroeconomic and external stability of the country, as one of the factors to the upgrade the ratings.