

Keynotes of NBK Deputy Governor Aliya Moldabekova Concerning Pressure on EM Currencies and Growing Income of the National Fund

Continued acceleration of global inflation and slowdown in the global economy pose new risks and potential uncertainty for central banks. Expectations that the US Fed will increase the interest rate as early as next year are putting pressure on emerging market currencies. Along with that, oil quotes continue to climb.

Concerning situation on foreign markets in October

Release of data on GDP of leading countries of the world has confirmed expectations of a slowdown in the economic growth in the third quarter of 2021. In China, economic growth accounted to 4.9% against 7.9% in the second quarter of 2021, in the United States, data also show a noticeable decrease in growth in the third quarter down to 2% (according to preliminary data) from 6.7% in the previous period. According to JP Morgan's estimates, the global economy slacked up by 3.1% in the last quarter, having decelerated from 4.4% in the second quarter of 2021.

Despite the slowdown in the economic activity, inflation supported by supply and demand imbalance caused by the pandemic, high commodity and food prices, remains high and continues to accelerate. The US CPI Index in September reached 5.4% y/y (5.3% in August), in the Eurozone the indicator updated another record over the past 13 years, rising up to 4.1% in October.

It should also be noted that the short-term segment of the US Treasury yield curve is rising, which usually takes place when expectations of rate hikes intensify. Yields on 5-year US government securities reached 1.18%, the highest level since February 2020, which narrowed the gap between 30-year and 5-year securities to the lowest level over the last eighteen months.

Thus, rising yields on US Treasury bonds in anticipation of an imminent hike in the Fed's rate, slowdown in Chinese and US economies put pressure on emerging-market currencies over the past month. The MSCI EM Currency Index lost 0.8% in October: the Brazilian real fell 3.7%, the South African rand - 1.1% and the Indian rupee fell 0.9%. The Turkish lira depreciated by 8.1% amid easing monetary policy, despite the acceleration of inflation.

Regardless of negative sentiment in the foreign exchange market, the global stock market has demonstrated a significant increase in October: the MSCI World Index grew by 5.6% as a result of record profits at the end of the reporting season for companies in Q3 2021.

Prevailing TINA mentality (there is no alternative) among investors in the context of instability in the bond markets on the eve of rising rates and growing inflationary expectations as well as a large amount of free liquidity contribute to resumption of growth in equities of developed countries.

Regarding the situation on the oil market and factors that affected the rise in price quotes in October

Lack of natural gas creates an extra demand for petroleum products. In October, global oil prices rose by 7.5% to USD 84.38. Analysts estimate that switching from natural gas to oil could add 250,000 to 750,000 barrels of daily crude oil demand.

The oil market prices was supported by results of the October OPEC+ meeting, when the alliance members refrained from increasing extra supply and agreed to monthly increase of daily production volume by 400,000 barrels.

Against the background of the energy crisis, the Brent oil price reached a maximum level of USD 86.7 as of October 25, 2021, it is the highest value since October 2018. By late October, oil prices slightly adjusted following the background of reports of an increase in oil reserves. The adjustment also depended on the significant impact of Iran's negotiations with the world powers over its nuclear program: if it's successful - sanctions against Iran and the ban on oil exports could be lifted.

The OPEC+ meeting on November 4 also passed without changing the previously agreed plans to increase oil production by 400 thousand barrels daily. However, the oil market was under pressure from the US President's urges to boost oil production in order to stabilize prices.

Oil price as of November 9 stood at USD 83.3 per barrel, down 1.2% from early November. Currently, oil prices have stabilized, on the one hand, given increase of Saudi Arabia's selling oil prices, and on the other hand, absence of a decision by President J. Biden to use the US strategic oil reserve in order to cut fuel prices.

Regarding the lack of response of the KZT exchange rate to positive dynamics in the oil market

The oil price remains one of the key macro factors for KZT exchange rate as the oil price determines the volume of foreign exchange supply in the domestic market. However, there are many other components, both internal and external, that affect the exchange rate formation, and this situation is common for currencies of all the markets, both developed and emerging.

First, growing imports amid recovery in the economic activity and fiscal impulse continues to exert constant pressure on the KZT exchange rate. Therefore, despite the growth of foreign exchange earnings of exporters as a result of a rally in the oil market, the reported growth in demand for foreign currency does not allow the tenge to strengthen. Moreover, due to increased imports of consumer goods, current account of the balance of payments remains in deficit.

Increasing imports of the Russian goods are a vivid example of a growing demand for foreign currency from business and households. In my recent interview, I have already indicated that according to the results of the second quarter of this year, imports from Russian Federation reached USD 4.2 billion, a 36.1% year-on-year surge, while the same indicator in the first quarter of this year was 2.4%. Thus, the increased domestic demand for goods from the Russian Federation leads to a weaker KZT exchange rate against the Russian ruble. This October, KZT exchange rate against the ruble depreciated from 5.85 to 6.05 KZT per ruble or down by 3.4%.

Second, in conditions of free floating rate, the tenge directly responds to global trends. USD appreciation against the background of tapering of quantitative easing programs and market expectations for Fed's rate hike in 2022 creates a negative sentiment among investors towards emerging markets.

Third, a weak link between growing commodity prices this year and dynamics of currencies of commodity economies was seen in a global context. The Canadian dollar, the Norwegian krone, the Russian ruble, despite the double-digit oil growth since the beginning of the year, could not demonstrate comparable strengthening. Some analysts correlate this situation not only to global strengthening of the USD but also with the lack of confidence in a long-term growth in oil prices. In their opinion, this is due to a temporary nature of the observed energy crisis as well as a potential increase in production by OPEC+.

As a result, despite the rise in oil prices, the national currency depreciated by 0.3% over the month, to 427.15 KZT per USD.

The National Bank did not conduct foreign exchange interventions. The tenge was supported by operations to convert funds of the National Fund in the amount of USD 988 million to make transfers to the budget and obligatory sales by subjects of the quasi-public sector in the amount of USD 208 million.

Along with that, the increase in the base rate to 9.75% maintain the attractiveness of debt instruments in KZT, as evidenced by the growth in the volume of investments of non-residents in government securities of the Republic of Kazakhstan in October by 75 billion to 863 billion (an increase from the beginning of the year - 433 billion). Additional supply of foreign currency from foreign investors contributes to improvement of market liquidity and partial satisfaction of demand.

The tenge has weakened by 0.5% to 429.20 since the beginning of November amid falling in oil prices.

Regarding dynamics of gold and foreign exchange reserves in October

Gold and foreign exchange reserves at the end October this year amounted to USD 35.8 billion, which is USD 307 million more as compared to the beginning of the month. Assets in freely convertible currencies shrank by USD 854 million, mainly due to a decrease in balances on correspondent accounts of second-tier banks.

Gold portfolio in gold and foreign exchange reserves expanded by USD 1.2 billion in October due to a rise in prices for the precious metal and purchase of gold subject to the priority right. Thus, gold price in October rose by 3.8% from USD 1,731 to USD 1,796 per ounce, amid fears of a surging inflation, which together made it possible to compensate for a fall in the value of assets in freely convertible currency and ensure an increase in reserves.

Regarding factors that affected volume of foreign exchange assets of the National Fund in October

According to preliminary data, at the end of October, currency assets of the National Fund totaled USD 55.1 billion, practically unchanged over the past month.

For allocation of guaranteed and target transfers in October, assets were sold in the foreign exchange market in the amount of USD 988 million, which is equivalent to 420 billion KZT. At the same time, in order to meet needs of the republican budget from the National Fund, transfers were allocated for almost 428 billion KZT.

October inflows to the Fund made 103 billion KZT, of which USD 163 million were received in foreign currency.

In September we witnessed a significant correction in the markets, then in October there was a recovery in the stock market and its further growth. As a result, investment income of the National Fund in October was positive and amounted to USD 871 million, mainly due to the growth of equity and gold by 5.69% and 3.78%, respectively. Due to the balanced allocation of assets of the National Fund, investment income has recovered since the beginning of the year and amounted to USD 2 billion, or 3.44%.

In November, market volatility persists, stocks continue to show growth. Against this background, since the beginning of this month, investment income of the National Fund has grown by another USD 470 million and since the beginning of the year it makes USD 2.45 billion or 4.3%.

Regarding prospects for development of the situation in foreign markets in the near future and their possible impact on the tenge

Financial markets are currently most susceptible to changes in rhetoric in the very monetary policy of the world's leading central banks. Thus, participants of the financial market are setting higher inflationary expectations and an earlier key rates hike. The rate hike cycle in the US, Canada, Australia and the UK is expected to begin in 2022.

The beginning of a cycle of rate hikes by developed countries in response to expectations of rising inflation creates risks of capital outflows from emerging markets. EM currencies are under pressure against the background of continuing strengthening of the USD and rising yields of government securities in developed countries. At the same time, Fed's monetary policy tends to have the greatest impact on value of EM assets.

Some analysts are also concerned about risks of global stagflation - an economic downturn accompanied by rising inflation. Amid rising inflationary expectations, pace of monetary tightening may slow down business activity and, as a result, slow down the economic growth. In this connection, the actions of regulators should be focused not only to reducing inflationary risks but also to prevent a deceleration of the economic growth.

A more sustainable growth of oil prices is a positive factor for the tenge. Despite retention of a positive forecast for dynamics of oil prices until the end of the year, deficit in the oil market is expected to narrow in 2022. Moreover, volatility of oil prices remains due to a potential increase in OPEC+ production if the US President's Joe Biden's urges are satisfied, further convergence of positions of the US and Iran and lifting sanction sanctions on oil exports, deterioration of the epidemiological situation and other factors.

In general, continued growth in oil prices as well as upcoming large tax payments in November create support for the tenge in the near future. However, stable demand for foreign exchange and volatility in foreign markets can offset this effect.