

Keynotes of NBK Deputy Governor Aliya Moldabekova About Volatility on Global Markets and Reasons of Tenge Depreciation

Discovery of a new coronavirus strain in late November has become serious trigger and the cause of global volatility. Last days of November and early December turned out to be a challenge for the domestic market as well: tenge was under pressure from a mix of internal and external factors.

About situation on foreign markets in November

In November, a lot of risk scenarios did materialize, which drastically affected market expectations that had been formed earlier. As a result, we saw a new wave of global flight from risky assets and capital flow to developed countries and 'protective' instruments.

At the beginning of the month, the Fed announced start of tapering of its asset purchase program. In the US, inflation was record high for the past 30 years, accelerating to 6.2% y/y in October. This only enhanced fears of more rapid tightening of Fed's policy, as a result of which the USD strengthened globally and Treasury bond yields rose. This in turn has negatively affected currencies and assets of emerging markets.

By the end of the month, the situation rapidly deteriorated. Thus, on November 26, news spread about discovery of a new coronavirus strain – Omicron. Although emergence of the new Covid-19 variant has always been treated as a potential risk factor, Omicron has become a kind of 'Black Friday' for the financial markets.

Following identification of the new strain and uncertainty about its infectivity and resistance to vaccines, outflow from emerging markets has accelerated and has taken on new dimensions. At the end of November, the EM currency index demonstrated the lowest plummet in the year, by 4.4%.

Shares as a volatile and risky asset class, also sagged: the MSCI developed market index fell by 2.3% in November, while the emerging market index declined by 4.1%.

On the last day of the month, comments of Fed's Chairman J. Powell concerning plans to consider a faster pace of tapering of the asset purchase program at the next December meeting added negative comments.

Additionally to general volatility, markets were also shaken by certain regional risk events. These included currency crisis in Turkey and resumption of sanctions rhetoric towards Russia. Against the background of a key rate cut amid high inflation, Turkish lira plummeted by 40% for the month. The US authorities are discussing possible introduction of new sanctions, which, in their opinion, must prevent escalation of a military activity on the border with Ukraine, as a result, the Russian ruble depreciated in November by 4.7% down to 74.15.

About situation on the oil market and factors that caused decline in quotations

The situation on the oil market in November was extremely negative: oil prices in November plunged by 16.4% from USD 84.38 to USD 70.57 per barrel. Oil quotes fell back to three-month lows.

In the first half of November, there was a question to contain prices. The United States and other large importing countries studied an opportunity to sell oil from strategic reserves against the background of OPEC+ refusal to increase production above the target. However, rising morbidity and resumed restrictions in Europe, total social isolation in Austria and

tightening restrictions on the unvaccinated in Germany have triggered off a sharp slump in demand in the European area.

By late November, news about discovery of the new strain, risks of global lockdowns and a drop in demand for petroleum products put significant pressure on oil prices. On November 30, the price fell below USD 69 per barrel.

December began with a regular OPEC+ meeting, the alliance countries stuck to their stance as to increase the output by 400 thousand barrels daily in January. The market responded with a plunge, oil price reached USD 65.7 per barrel. In the following days, oil quotes rose supported by expectations that the situation with the Omicron would follow a positive scenario as well as an increase in contract prices for Asia and the US from Saudi Arabia. Current oil quotes have consolidated at USD 75 per barrel.

About impact of risk events in external markets on tenge dynamics

Amid implementation of risk events in external markets, the tenge has sustained a significant pressure. According to last month's results, the tenge lost 1.7% of its value down to 434.20. Negative dynamics of the national currency was concentrated during last days of the month. Identification of the new coronavirus strain was a main trigger which drastically worsened the situation in the domestic foreign exchange market.

First, Omicron was a main reason behind falling oil prices. Quotations for the day – November 26 – declined by almost 10% from 81.65 to 73.58. Tenge, like other currencies of oil-exporting countries, responded with abatement.

Second, global escape from emerging markets had a direct impact on the foreign exchange market in Kazakhstan. We witnessed a large-scale exit of non-residents from tenge positions. According to our calculations, by late November, non-residents converted from tenge to foreign currency an amount for nearly USD 670 million. This included a withdrawal of portfolio investors from Kazakhstan's government securities, which amounted to nearly USD 190 million.

In conditions of a rapid deterioration in the above-mentioned fundamental factors, demand for foreign currency from legal entities and individuals has almost doubled. Trading volume on the stock exchange on November 29 and 30 reached record volumes – about USD 260 million daily. Against the background of speculative demand in order to ensure financial stability, for the first time since October 2020, the National Bank in the last two days of November carried out foreign exchange interventions for a total amount of USD 239 million.

Against the background of a sharp increase in demand for foreign currency, total volume of exchange trades in the tenge-dollar pair reached record USD 3.7 billion last month. Along with that, sale of foreign currency from the National Fund to ensure transfers in November amounted to USD 617 million. Sales volume of foreign exchange earnings by companies in the quasi-public sector made USD 315 million.

Despite the fact that November is the so-called tax month, expectations for support of the tenge during the major tax week did not materialize also because exporters used the available tenge liquidity to pay taxes.

During the first days of December, amid continuing volatility in oil prices and reaching a local minimum of USD 65.7 per barrel, tenge continued to experience strong pressure from non-residents, higher demand from the population and legal entities. Dollar exchange rate in non-bank exchange offices in some periods exceeded the benchmark of 440 KZT/USD.

Since the beginning of this week, after the oil prices adjusted and such an ‘emotional’ response of the market, the situation has stabilized, tenge is traded today at 434.40 KZT/USD.

About information from professional market participants about spread of more than 1% of quotes on the interbank market formed at the KASE trades, and about reasons behind temporary absence of market makers

The interbank market is an unorganized market, where the main participants are the so-called ‘market makers’, our second-tier banks that actively support quotations as well as non-residents – mainly global investment banks.

Unlike an organized trading platform of the KASE, where transactions are carried out with a central counterparty, participants in transactions on the interbank market bear risk of counterparty’s failure to deliver. Therefore, difference in quotations between the exchange and the interbank market is okay. According to data from trading systems, an average spread between quotations is 1-1.5 tenge. The Interbank is of interest to market participants, both internal and external, and is formed without NBK involvement.

Against the background of a soaring demand for foreign currency in late November - early December, the domestic foreign exchange market was featured by extremely low liquidity due to a limited supply. In such situation, banks, as a matter of priority, satisfied the increased demand from domestic customers. Residual satisfaction of bids by the interbank market came out as a shrinking activity of market makers, which caused a decrease in liquidity and widening of spreads in the interbank market.

Contracted activities of market makers and increased demand for purchases by non-residents kindled a temporary expansion of the spread of the interbank market with exchange quotations to more than 1%, or 4 tenge, at some moments during an auction on December 2. According to data of trading systems, already on December 3, this spread recovered due to restoration of a balance in the foreign exchange market and was in the range of up to 1.5 tenge.

About dynamics of gold and foreign exchange reserves amid volatility and influence of additional factors

Gold and foreign exchange reserves at the end of this November totaled USD 35.5 billion, with a USD 309 million decrease at the beginning of the month.

Foreign exchange portion of reserves shrank by USD 575 million following completed interventions, payment of government debt and other transactions on government's accounts.

Along with that, gold portfolio partially offset the decline in foreign currency assets, increasing by USD 267 million due to purchase of gold within implementation of a priority right of the government.

About factors which affected volume of foreign exchange assets of the National Fund

According to tentative data, in late November, foreign exchange assets of the National Fund made USD 54.9 billion. They demonstrated a slight decrease over the past month by USD 140 million.

As I have already mentioned, in order to allocate transfers to the republican budget, assets worth USD 617 million were sold in the foreign exchange market, which is equivalent

to 263 billion KZT. Total amount of the transfer in November amounted to 310 billion KZT, part of which was satisfied at the expense of receipts to the National Fund.

Due to implementation of tax payments by organizations of the oil sector, November saw an increase in foreign exchange earnings to the National Fund, which made nearly USD 1 billion.

Against the background of significant volatility in the financial markets associated with the new strain, investment income of the National Fund in November decreased to (-) USD 540 million, mainly because of a 2.11% decline in share portfolios. Because of growth of government securities yields in developed countries and the global USD strengthening against the background of tightening monetary policies, bond portfolio of developed countries also showed a decline. Its yield in November was (-)0.64%.

Investment income of the National Fund since the beginning of the year has remained positive and totaled USD 1.4 billion, or 2.52%.

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

Discovery of the new strain, volatility in oil prices, growing global inflation and, as a result, tightening of monetary policies by most central banks are the main challenges in global markets in the near future. It was these factors that had a significant negative impact on EM currencies, including the tenge.

The new coronavirus variant has already spread to 38 countries and, in an unfavorable scenario, it can decelerate the global economic recovery. Experts indicate that more mutations are known to exist than in previous strains. This may be associated with a greater infectiousness of the virus and its resistance to available vaccines.

However, in order to confirm danger from Omicron, it is necessary to have official test results. Thus, chief medical adviser to the US President A. Fauci said that preliminary data from South Africa do not yet give grounds to conclude that the new strain entails higher hospitalizations.

Of course, spread of the new strain puts pressure on oil prices due to fears of a sharp drop in demand for fuel because of possible large-scale introduction of new restrictive measures. However, based on results of its last meeting, OPEC+ not only decided to stick to the current plan to increase oil production due to absence of objective signs of a decreasing demand for oil products but it also announced its readiness to urgently revise parameters of the transaction if the epidemiological situation gets worse around the world.

In conditions of the global post-pandemic recovery, pro-inflationary pressures persist. Thus, inflation rates in the largest economies exceed target levels. In particular, this increases the likelihood of a faster rollback of the quantitative easing program and start of the US Fed's rate hike in 2022. In this regard, USD strengthening continues, which puts widespread pressure on EM currencies.

As for key internal factors, the end of the year is traditionally featured by development of budgets of all levels, signing of acceptance certificates, and, consequently, an increasing demand for foreign currency and, accordingly, pressure on the tenge. But in this case we are talking about a traditional Pre-New Year's demand for foreign currency within current imports and needs of households.

About impact of dynamics of the Russian ruble exchange rate and potential new sanctions against the Russian Federation on the domestic foreign exchange market of Kazakhstan

Geopolitical risks and sanctions rhetoric put pressure on the Russian ruble. Yesterday, a video conference was held between the presidents of Russia and the US. It kicked off mutual consultations on a broad range of issues, including relations with Ukraine. As a result, the ruble exchange rate was adjusted and got stronger by almost 0.5% up to 73.9.

Given that in January – September 2021, the Russian goods account for 41% in our imports follow, depreciation or appreciation of the ruble as a currency of one of the key trading partners certainly affects the tenge. However, it should be pointed out that sanctions rhetoric of Western countries against the Russian Federation has been going on for a long period of time, with a rather indirect influence on the exchange rate of the tenge for the present.

We have already repeatedly indicated that tenge dynamics depends not only on movement of the exchange rates of the countries which are trading partners. Exchange rate is formed under the influence of a number of internal and external factors. The oil price continues to play an important role as the country's main export commodity. The National Bank continues to closely monitor the situation and is ready to take adequate measures to ensure stability in the market.