National Bank About Situation on Financial Markets and Tenge Appreciation

Global interest rate hikes have turned out to be one of key factors that determine dynamics of global financial markets this year. Along with that, focus of global investors has begun to gradually shift to signals about a peak in inflation and rates, which may ultimately lead to a possible paradigm shift in the global dominance of the USD. Aliya Moldabekova, Deputy Governor of the National Bank of the Republic of Kazakhstan, has commented on how this affected the global foreign exchange market, what affected the tenge exchange rate in October and key factors in dynamics of international reserves of the country.

– Aliya Meirbekovna, what events had the main impact on dynamics of the global financial markets? Did the global dominance of the USD continue in October?

– There were the first signals of easing in the rhetoric of a number of central banks in October, in particular, in Australia, Canada and the Eurozone. The Bank of Australia and the Bank of Canada, unexpectedly for global investors, decelerated the pace of rate hikes. Accordingly, the Bank of Australia increased the base rate by 25 b.p. to 2.6%, while 50 b.p. was expected, and the Bank of Canada – by 50 b.p. to 3.75%, with 75 b.p. hike expected. The ECB raised the rate by 75 b.p. to 2%, however, investors noticed a tone for easing policy in the future in the rhetoric of the head of the Eurozone Central Bank. Christine Lagarde said that the ECB has made significant progress in withdrawing monetary policy accommodation. As a result, after the meeting, despite the rate hike, the Euro exchange rate depreciated by 1.2%, falling to a level below parity.

Expectations that the US Fed may soon follow the lead as well as reports of some US Fed officials wanting to slow down the pace of hikes soon and stop raising early next year, halted the USD global dominance in October.Last month the DXY index weakened by 0.5%, to 111.5 points.

Along with that, the rhetoric of the US Fed in the context of stable inflation, which amounted to 8.2% y/y in September, continues to be hawkish. At the last meeting in November, The US Fed Chair signaled that the rate may reach a higher peak value than previously expected. According to the latest September median forecast of the scatter plot, or Dot Plot as it is also called, the rate peaked at 4.5-4.75%, which suggests that the December update of the plot is likely to show a higher level. Despite the unprecedented tightening of monetary conditions, the US economy demonstrated resilience, GDP in the third quarter of 2022 grew by 2.6% q/q after two consecutive quarterly cuts.

In view of investors' expectations of a slowdown in the pace of tightening by leading central banks and an improvement in the risk sentiment, the stock market demonstrated a recovery in the last month. The MSCI World Index rose by 7.1% after it lost 9.5% in September.

Oil prices also benefited from favorable risk sentiment, with prices up by 7.8% in October to USD 94.83/bbl. At the same time, OPEC+ alliance decision to significantly cut production volumes was a key factor explaining a rise in oil prices last month. In early November, reports of China's intention to ease the Covid Zero policy gave a new impulse to prices of black gold, quotes rose to USD 97 per barrel.

– How can the situation on the domestic foreign exchange market be described, were there any interventions?

– In October, we witnessed moderate volatility on the foreign exchange market. Dynamics during the month was multidirectional, in October tenge gained 1.7%. The main reason behind tenge appreciation was rising oil prices. The increase of the base rate and the sale of quasi-public sector entities also supported the tenge.

Sales of foreign currency from the National Fund in October totaled USD 362 million, while volume of sales during the trading day did not exceed USD 30 million. We have repeatedly indicated that foreign currency from the National Fund is sold only when it is necessary to ensure a transfer to the republican budget. We do our best to minimize impact of these operations on the foreign exchange market. When conducting foreign currency sale transactions, the National Bank acts as a price-taker, that is, it 'fills' the existing orders without placing its own. By agreeing with the price of market participants, we rule out impact of transactions on the market rate.

The foreign exchange market is currently balanced, there was no need for foreign exchange interventions.

– What happened to gold and foreign exchange assets in October?

– In October, gold and foreign exchange assets expanded by almost USD 330 million to USD 33 billion.

Growth of gold and foreign exchange assets is attributed to the inflow of client funds and commercial banks' funds to foreign currency correspondent accounts with the National Bank. However, the effect of the above factors was partially offset by payment of the public debt, as well as the decline in the price of gold from USD 1,673 to 1,639 per ounce.

Decline in the gold price was attributed to response of market players to the hawkish rhetoric of the US Fed. Volatility on the market of precious metals is still quite high.

It is also worth noting that in October the National Bank continued to implement its policy to reduce the gold share in order to diversify international reserves, therefore gold was sold for hard currencies.

– How did volume of foreign exchange assets of the National Fund change in October and what factors influenced it?

– According to tentative data, in late October volume of foreign exchange assets of the National Fund made USD 52.4 billion with a USD 850 million increase for the past month.

In order to allocate guaranteed and target transfers in October on the domestic foreign exchange market, as previously noted, assets were sold in the amount of USD 362 million, which is equivalent to 171 billion KZT. In order to meet needs of the republican budget, transfers worth 327 billion KZT were allocated from the National Fund.

As a result of the growth of stock markets in October, the stock portfolio has slightly recovered a part of the fall since the beginning of the year. Along with that, long-term profitability of the National Fund since the beginning of its creation in annual terms is 2.88%.

– What will determine the situation with oil prices and on the world currency market in the future?

– Tight monetary policy of the US Fed remains a key driving force of the global appreciation of the USD. Therefore, the question of how long this US Fed cycle of tightening will last remains the main factor of uncertainty for the global currency market.

As we have seen this year, central banks worldwide have made a sharp and rapid increases in rates. Global investors are searching for a peak in this tightening cycle. According to an analysis by Goldman Sachs (85 episodes of rate hikes among the G10 countries), the rate hike cycle lasts an average of 15 months, with 70% of all episodes lasting more than a year. In general, if favorable economic conditions continue without a recession, the US Fed's rate hike cycle, according to some economists, will be longer, but at the same time more consistent next year. At the next meeting of the US Fed in December, analysts predict a reduction in the pace of rate hikes to 50 b.p., and two increases of 25 b.p. each in February and March 2023. According to consensus of Bloomberg analysts, the DXY index is expected to weaken in 2023.

Moreover, it should be noted that a potential U.S. Fed policy reversal may not end the dominance of the USD due to its safe-haven status during a period of geopolitical uncertainty and high yields in absolute dollar terms.

As for the oil market, due to a decision of OPEC+ of cutting production in order to offset the potential decline in fuel demand due to expectations of a slowdown in the global economic growth, the oil price showed a significant recovery.

However, these quotas are valid only until the end of this year, so the decision on duration of these cuts will affect the balance and dynamics of the market in 2023. In turn, the United States strongly opposed the latest OPEC+ decision and is considering a number of retaliatory measures, including the release of oil from state strategic reserves, as well as consideration of the adoption of the NOPEC law, which would prohibit cartel price setting through filing an antitrust lawsuit against OPEC members. However, adoption of this law is unlikely. In general, forecasts of economists for oil prices for the first quarter of 2023 are within the range of USD 84-115 per barrel.