

## **Minutes of the XII meeting of the Working Group on Money Market Indices (MMWG)**

*March 1, 2023, Almaty*

On March 1, 2023, the XII meeting of the Working Group on Money Market Indices (hereinafter – Working Group) was held in Almaty with the participation of representatives of the National Bank of Kazakhstan (NBK), Agency of the Republic of Kazakhstan for Regulation and Development of Financial Market (ARDFM), European Bank for Reconstruction and Development (EBRD), JSC "Kazakhstan Stock Exchange" (KASE), and second-tier banks (banks).

According to the Agenda the following issues were discussed during the meeting.

### **I. KASE presented an analysis of the money market in Kazakhstan.**

1. Repo transactions in 2022 amounted to a total of 202.6 trillion tenge, which is by 61.0 trillion tenge, or 43.1 %, more than the volume of trading in 2021.
2. In the first half of the year, more than half of all borrowings in the repo market were raised by the banking sector, in the second half of the year, the share of the banking sector in the total trading volume was systematically decreasing, while the volume of borrowings by the non-banking sector was increasing. With regard to the terms of liquidity raised, banks dominate in short periods of 1 to 3 days, while terms of 3 days and more than 10 days are more characteristic for the non-banking sector.
3. In terms of collateral securities, the largest amount of funds is raised with GS of the Ministry of Finance of the Republic of Kazakhstan and securities of Kazakhstan Sustainability Fund JSC (KSF) as collateral. At the same time, banks prefer securities of the Ministry of Finance of the Republic of Kazakhstan as collaterals, the non-banking sector – KSF.
4. Broken down by trading modes, the largest volume of trading takes place in the "autorepo with the CCP" mode. The non-banking sector operates mainly in the modes of direct repo and repo without the CCP.
5. The main liquidity providers during the period were non-banking institutions.
6. The total volume of currency swap transactions in 2022 increased from 11.0 trillion to 29.2 trillion tenge, or 2.6 times. Raising liquidity through a currency swap: in the first half of the year, in terms of fund raising, as well as repo transactions, banking structures were the most active, in the second half of the year the share of the non-banking sector began to grow sharply. Most of the swaps fell on the USD/KZT pair. Since March 2022, the participants have started to enter into swaps in rubles.
7. KASE indicated that TONIA in 2022 was shaping up within the interest rate corridor.

### **II. The NBK provided an overview of the banks' responses to the money market questionnaire.**

1. Various questions were answered and discussed by second-tier banks with regard to: prudential norms that are limiting the development of interbank lending; the reasons why NBK deposits and NBK repos are more attractive than interbank deposits and repos with other market participants; inconvenience of settlements with KASE when placing liquidity using KASE repo; interest and currency risks management; counterparty limits; liquidity management process; sensitivity to interest rates; costs associated with liquidity withdrawals by clients.
  2. Second-tier banks noted limitations in the use of their dollar liquidity due to the CDA requirements. At the same time, reserve requirements are only formed in tenge, and NBK deposits are not included in the calculation of the coefficient of highly liquid assets. In this regard, it was decided to work out this issue with the ARDFM.
- I. EBRD has announced plans to launch a Money Market Diagnostic Framework (MMDF)**
1. The MMDF is a diagnostic tool via a questionnaire to all Money Market participants that takes the snapshot of money market condition at a given point in time to assess the state of development of money markets, identify the main obstacles to it and provide recommendations. The questionnaire will be structured around the current level of Money Market development, environment, central bank's role and resources.
  2. EBRD noted, that the MMDF is a very useful tool to support country's money market development work and also to compare to other markets. Re-running it regularly can help track developments through time.
  3. Respondents/stakeholders include central bank units, regulator, market infrastructure providers (CSD, stock exchange, etc.) and market participants of all types (banks, investment companies, asset management firms, brokers, etc.).
- II. EBRD emphasised the importance of harmonisation/standardisation of conventions, in particular, calculation conventions between different products.**
1. EBRD noted that aligning conventions as much as possible between products allows to manage the balance sheet more efficiently, thus, reducing basis risk.
  2. EBRD also proposed the OIS conventions for tenge denominated products.
- III. EBRD told about the relevance of the issue of standardization in the bonds' market of Kazakhstan**
1. The EBRD recalled the first floating rate local currency bond issue linked to TONIA in November 2021. The coupon calculation formula in this case refers to the compounded index.
  2. The EBRD advised market participants to use the formula for calculating the coupon rate used for the bonds of the EBRD, as well as NC Kazakhstan Temir Zholy JSC, Samruk-Energy JSC, based on compounded index (TONIA Compounded Index - TCI), available on the KASE website.
  3. The EBRD noted the following advantages of using the compounded index.

- o Replication of daily cash rollover in the money market, resulting in a better alignment with return on cash in money markets.
  - o Consistent with adopted practices in developed markets (SOFR for USD and SONIA for GBP).
  - o Using compounded indices allows to simplify the calculation of the daily compounded rate over any accrual period and therefore avoid discrepancies and operational mistakes in the calculation.
4. The EBRD compared the coupon rate calculation of the Ministry of Finance METIKAM that is linked to the 6-month backward compounded TONIA rate (TCR\_6M) as opposed to compounded TONIA over the interest observation period. The EBRD believes that the current calculation of the METIKAM coupon rate is not optimal as it leads to a number of problems, namely to suboptimal price discovery between buyers and sellers when transacting between coupon dates, for example, secondary placements of existing bond issuances. The EBRD displayed how TCR\_6M is a lagging reference rate for a FRN and fails to capture current cost of overnight liquidity. In an environment when interest rates are rapidly rising, as was the case in autumn 2022, the EBRD argues that arbitrage opportunities appear. In theory, investors are able to switch away from METIKAM to overnight money market while rates are converging (i.e. METIKAM coupon rate catches up to current money market interest rates at the end of each interest period); but in practice, this leads to larger premiums asked for FRNs on secondary placements.
  5. Moreover, given that balance sheets are mainly managed in overnight money market, existence of different reference rates for FRNs introduces basis risk into banks' balance sheets – in this case a basis risk between TCR\_6M and compounding the o/n cost of funds as captured by TONIA over the same coupon periods.
  6. The same basis risk will also arise when investors in METIKAM bonds will want to manage interest rate risk with Overnight Index Swaps (OIS) as the latter instruments will use similar compounding conventions for TONIA as those used in the compounded index. Said basis risk may also lead to investors asking larger premiums.
  7. Another issue, albeit a smaller one, is that TONIA uses a calendar basis of "actual number of days/365", whereas the calendar basis for METIKAM is 30/360. This also introduces another kind of basis risk.
- IV. The participants proposed that the ARDFM prepares a report for the next meeting on the current status of the development of the regulatory framework for derivatives transactions in the Republic of Kazakhstan.**