Keynotes of NBK Deputy Governor Aliya Moldabekova Concerning Tapering of Monetary Incentives and Continued Import Demand

Ongoing spread of the delta strain and new quarantine restrictions put pressure on oil prices in August. Representatives of the Fed and the ECB speak about feasibility to taper quantitative easing programs.

Concerning situation on foreign markets and main scenarios for development of the situation in emerging markets.

Against the background of influence of contradictory factors, situation on foreign markets was quite multidirectional. On the one hand, the concerns of global investors remain focused on risks of a slowdown in the global economy (delta risk) and start of tightening of the US Fed's monetary policy.

Amid widespread prevalence of the delta strain of Covid-19, the aggregate indicator of global economic activity (PMI Composite) continued to slow down in August, reaching 52.6 points (55.7 in July). Key factor behind the slowdown in August was declining activity in the service sector (China by 8 points, the UK and the US by 5 points). Despite the fact that indicators show an expansion of global economic activity (level above 50 points), they remain below the peak reached in May (58.4), which signals a slowdown in the global economy in summer months. Concerns about impact of the delta strain on the global economy have put pressure on investor risk sentiment, and, consequently, on emerging market currencies and assets.

The markets also responded to the signals from the US Fed regarding tapering of support measures. Strong report on the US labor market for July released in the first week of August (number of jobs rose by 1,053 thousands, above analysts' expectations) again became a catalyst for fears about a need to roll back stimulus from the US Fed by reducing the pace of asset purchases this year.

On the other hand, the 'soft' speech of the Fed's Chairman at the symposium in Jackson Hall was risk-positive for global markets. Despite the confirmation of the fulfillment of the precondition for achieving a 'significant progress in the labor market' to start tightening policy, Powell warned that tapering of monetary stimulus is not a signal for an early increase in fed funds rate.

As a result, by the end of the month, emerging market currencies completely regained back their negative dynamics, ending the month at a neutral level - EM index strengthened by 0.35% in August. Risky assets also received support after the speech of the Fed's Chairman and major US stock indices continued to rise in August: S&P + 2.9%, Nasdaq + 4%, Dow Jones + 1.22% MoM.

Concerning reasons for higher turbulence of oil prices and prospects for further increase in oil prices

The volatility in the oil market actually rose in August. The prerequisites for a decline in oil prices were formed from the first days of the month amid fears about demand for fuel, in particular, from the largest oil importer, China. Data on economic activity in China in July showed a slowdown to 50.3 points (from 51.3 in

June). Moreover, against the background of absolute intolerance to Covid-19, China began early introduction of strict restrictions (canceled flights, restrictions of public transport), which also put significant pressure on oil. Oil prices experienced one of the longest periods of decline (7 sessions in a row) and fell to 65 US dollars per barrel (-14.6% since the beginning of the month on August 20).

By late August, oil prices moved into a rapid recovery, reaching 73 US dollars per barrel amid data on declining US inventories, weakening of the USD exchange rate after a speech of the Fed's Chairman and disruptions in oil production in the Gulf of Mexico due to the storm. As a result, oil prices fell by 4.4% by the end of the month.

Volatility in the oil market may persist due to mixed signals about recovery of the US and Chinese economies amid risks of new strains of Covid-19, increased production under the OPEC+ agreement as well as increased production by American shale oil producers.

However, some analysts believe that delta risk is a temporary factor for the oil market (number of new Covid-19 cases in China is falling, incidence of the disease is stabilizing globally), and declining oil inventories and contracting investments in the oil and gas industry due to trends in transition to alternative energy sources should support further rise in prices.

Since the beginning of September, volatility of oil prices has remained elevated, prices have slightly fell to 72.5 or by 0.58%. Negative sentiment on the oil market is caused by concerns about increased competition between oil producing countries for market share amid lower prices by Saudi Arabia for Asian suppliers as well as continued impact of spreading delta strain of Covid-19.

A small support for oil prices was provided by fears of consequences of hurricane in the Gulf of Mexico due to halt of about 80% of oil production in the region. However, this support factor is most likely temporary, therefore unstable situation on the oil market is expected to continue.

Concerning impact of falling oil prices on tenge

Despite a significant drop in oil prices, tenge exchange rate weakened by only 0.2% in August to 425.42 KZT/USD. The sale of foreign currency by exporters to fulfill tax obligations smoothed volatility of tenge from declining oil prices. August is a period when exporting companies pay quarterly taxes (rent tax, mineral extraction tax, etc.), therefore amount of payments is larger than in the previous summer months.

Tenge was also supported by mandatory sales from quasi-public sector entities (USD 212 million) and conversion operations of funds from the National Fund for transfers to the budget.

Amid continuing recovery in economic activity, imports rose by 9.2% year-on-year in the first half of 2021. Coupled with continued fiscal stimulus, this supported increased demand for foreign currency.

The demand for foreign currency in cash also continued to increase. In July, the population purchased foreign currency in the amount of USD 624 million versus USD 555 million in June of this year.

I would like to note that the market was generally balanced, and in August the National Bank did not conduct currency interventions.

As of September 8, KZT/USD exchange rate amounted to 426.37, having weakened 0.2% since the beginning of the month due to the negative dynamics of oil prices.

Concerning dynamics of gold and foreign exchange reserves in August

According to preliminary data, gold and foreign exchange reserves at the end of August amounted to USD 36.8 billion, up by USD 1.8 billion for the month.

The increase in reserves was mainly driven by hard currency assets, which expanded by USD 1.7 billion. The significant increase is due to the receipt of Special Drawing Rights, or as they are commonly called SDRs, from the International Monetary Fund in the amount of USD 1.6 billion.

Despite the 0.8% decline in the gold price to USD 1,814 per ounce, the reserves were further supported by a USD 134 million increase in the gold portfolio through purchase of gold under the priority right.

Concerning special drawing rights and purposes of their use

SDR is an IMF's unit of account that can be exchanged for freely convertible currencies, and its value is pegged to a basket of major currencies: USD, Euro, Yuan, Japanese yen and pound sterling. IMF members can use the SDR at their discretion, for example, to repay a previously received loan from the IMF. Moreover, developed countries and countries with low debt burdens can voluntarily transfer SDRs in the form of assistance to more vulnerable countries in order to restore their economies after the crisis.

On August 23, the IMF Council issued a decision on the largest ever SDR issue and distribution for an amount equivalent to USD 650 billion (about SDR 456 billion). The additional SDR issue was distributed among the IMF member countries proportionally to their quotas in the organization. This allocation is intended to provide countries with access to extra funds, and thereby ensure stability for global economy during recovery from the crisis.

According to IMF quota, Kazakhstan received SDR 1.11 billion, equivalent to USD 1.6 billion. As you can see, the allocated SDRs added to the gross international reserves of the National Bank.

Concerning factors that influenced volume of foreign exchange assets of the National Fund in August

I have already mentioned multidirectional dynamics on global markets. In conditions of continued growth in equity indices, the National Fund's equity portfolio grew by USD 430 million, or 2.52%, offsetting the decline in bond and gold prices.

Volume of guaranteed and targeted transfers from the National Fund to the budget amounted to 396 billion KZT. In order to satisfy transfer requests, foreign currency assets were sold for USD 845 million or 359 billion KZT in tenge equivalent. The remaining obligations on transfers were satisfied at the expense of the balance of funds on the tenge account of the National Fund.

Given that August is a tax month, we have seen an increased volume of receipts to the National Fund. Thus, volume of receipts in foreign currency amounted to USD 506 million.

As a result, according to operational data, at the end of August, foreign exchange assets of the National Fund totaled USD 56.9 billion, practically unchanged for the month.

The investment income of the National Fund in August amounted to USD 316 million or 0.56%, and since the beginning of the year investment income has reached about USD 2.3 billion or 4.1%.

Concerning factors that affected decisions of international rating agencies when revising sovereign rating of the country

In August and early September, a round of revision of country rating was held by all three international rating agencies: Moody’s, Fitch Ratings and S&P.

In my last interview, I spoke about upgrade of the credit rating of Kazakhstan by Moody’s from “Baa3”, positive outlook, to “Baa2”, stable outlook. It is important to note that Moody’s has upgraded our rating for the first time since 2006, and Kazakhstan became one of the five countries in the world whose rating was upgraded, while the rating was revised for 144 countries in total.

Fitch Ratings and S&P have affirmed Kazakhstan's sovereign credit rating with a stable outlook.

Indeed, all three agencies noted presence of significant external reserves of Kazakhstan as a factor in maintaining country's resilience to external shocks, which has a positive impact on determining the sovereign rating.

As noted by the agencies, efforts to introduce a new fiscal rule and switch to a countercyclical fiscal policy will contribute to accumulation of assets of the National Fund and maintain a low level of debt burden in the future.

According to rating agencies, policy of the National Bank within the framework of the inflation targeting regime and the floating exchange rate support macroeconomic and external stability of Kazakhstan.

S&P analysts additionally indicated that improved transparency of the National Bank, in particular, publication of foreign exchange transactions of the National Fund, joint efforts of the National Bank with the Ministry of Finance on the construction of the yield curve, separation of financial regulation functions from powers of the National Bank, increase confidence in the monetary policy.

Concerning expectations for further dynamics of factors affecting the tenge exchange rate

Nothing has changed radically. On the domestic factors, ongoing recovery in economic activity and fiscal stimulus support demand for imports and, accordingly, demand for foreign currency.

As for external factors: delta strain of coronavirus remains the main risk of decreasing forecasts for economic growth rates. Slowdown in the global business activity is attributed to deteriorating situation in the service sector, such as catering and tourism, as well as restrictive measures in a number of countries.

Despite the recovery in global oil demand and a decline in oil storage reserves, slowdown in global economic growth may continue to put pressure on oil prices. Moreover, following the September 1 meeting, OPEC+ decided to maintain the pace of monthly increase in oil production by 400 thousand barrels per day, thereby creating preconditions for the oil price correction in case of a worsening epidemiological situation.

As for market sentiment, we continue to witness rising global pro-inflationary pressure. Against this background, representatives of the US Fed and the European Central Bank declare feasibility to taper quantitative easing programs. This may lead to increased volatility in the financial markets and, first of all, in relation to the assets of emerging markets.