

Keynotes of NBK Deputy Governor Aliya Moldabekova Concerning on the global correction of the financial markets and the pressure on the tenge

Most financial markets witnessed a decline in September: stocks, bonds and gold prices were falling. At the same time, crude oil is breaking records, exceeding USD 80 per barrel for the first time in the last 3 years.

Foreign market developments in September

In September, the number of new Covid-19 cases worldwide began to decline. As of October 5, the global weekly incidence rate dropped to 3.1 million from 4.4 million at the end of August. The relative improvement in the global epidemiological situation led to some stabilization of the economic activity indicators: the Global PMI showed a slight increase to 53 points for the first time in the last three months (from 52.5 in August). In general, due to relative reduction, although perhaps temporary, in the intensity of Covid-19 situation, concerns about impact of the pandemic on the economy and global markets have receded into the background.

The global financial markets in September were influenced predominantly by the change of rhetoric of central banks of the developed countries towards tightening of monetary conditions. The Fed has signaled it is ready to begin winding down its asset-buying program by the end of this year, given rising inflation and progress in the labor market. In addition, investors took note of adjustment of the forecasts of the Fed's committee members towards a faster rate hike: half of the committee members now predict an increase in the Fed Fund rate as early as 2022. The ECB has admitted the possibility of reducing the rate of asset purchases from 80 billion Euro to 60-70 billion Euro.

The expected tightening of US monetary policy has become the main reason for the strengthening of the US dollar, rise of treasury bond yields and a decrease in investor risk appetite. Towards the end of September, pessimism in the global markets intensified due to concerns of potential systemic risks related to financial challenges of large Chinese construction company Evergrande Group and disagreements in the US Congress over raising the US public debt limit.

Altogether these factors led to the outflow of capital from financial markets, the accumulation of the cash on accounts and resulted in a significant correction in the prices of stocks, bonds and gold.

As a result, at the end of the month, index of EM currencies against the USD weakened by 2.9%: Turkish lira lost 6.9%, Brazilian real - 5.7%, South African rand - 3.8%, Mexican peso - 2.8%.

The major U.S. stock indices were down for the first time in the last 3 months: S&P fell by 4.8%, while the global indices of developed and emerging markets stocks declined by 4.3% and 4.2% respectively.

Oil market in September

The situation on the oil market was the opposite. The price of Brent reached \$80 per barrel for the first time since October 2018. By the end of the month, oil prices rose by a significant 7.6% to USD 78.52 per barrel. Such a rapid increase in oil prices was the result of a number of reasons. Weekly data on crude oil showed inventories in the United States reached a 3-year low amid a faster recovery in fuel demand. Natural gas shortages in Europe and Asia also supported oil demand by an extra 0.5 million barrels per day as energy companies switched from natural gas to petroleum products ahead of the heating season. The market also has been supported by a slow recovery of the production in the Gulf of Mexico after Hurricane Ida - the region has not yet completely recovered its production capacity.

Increased volatility of oil prices persisted since early October: after the OPEC+ decision to continue gradual increase in oil production, in line with prior agreement (+0.4 million barrels per day), oil price grew. Then there was a sharp decline due to unexpected increase in inventories in the United States and lower gas prices after Russia's promises to increase supplies to Europe. During trading on October 11, quotes for the first time in the last 7 years exceeded USD 84 per barrel supported by a continuing growth in energy demand.

Why tenge did not respond to positive developments in commodities

Oil price, which is one of the fundamental factors for the national currency, certainly supported tenge. However, continued domestic demand for foreign currency and strong negative sentiment in global financial markets have become dominant factors in tenge dynamics.

Firstly, rising yields of US treasuries and global appreciation of the USD put pressure on emerging markets currencies. Despite a significant increase in oil prices, most currencies of the commodity economies of both developed countries and emerging markets were in negative territory - Canadian dollar depreciated by 0.5%, Norwegian krone - by 0.6% for the month, Indonesian rupee - by 0.3%.

Secondly, domestic demand for foreign currency continues to exert significant pressure on KZT exchange rate. Recovery in economic activity and growth of imports are limiting KZT appreciation. As a result, over 9 months of 2021, FX purchases of second-tier banks on the exchange rose by 19% year-on-year and reached USD 2.6 billion per month on average. Continuing effect of fiscal stimulus and allowed use of pension savings is another factor contributing to the increase of imports and growth in demand for foreign currency.

Thirdly, the breach of 424 KZT/USD rate, which is considered a comfortable level to buy foreign currency among population, has resulted in dip buying both in cash and on bank accounts. Resulting short FX position of the banks led to increased demand on the foreign exchange market.

By the end of September, KZT exchange rate slightly declined by 0.1% month-to-month to 425.75 KZT/ USD. Overall in the global context, the dynamics of the KZT exchange rate corresponds to general trends.

On the other hand, tenge was supported during the month by operations to convert funds of the National Fund in the amount of USD 913 million for transfers to the budget and sales by quasi-public sector entities, which amounted to USD 206 million. There was no need for currency interventions during the month.

As of October 11, on the backdrop of rising oil prices and an increase in oil price to USD 84 per barrel, KZT exchange rate strengthened by 0.3% since the beginning of the month to 424.55 KZT/ USD.

Gold and foreign exchange reserves in September

According to preliminary data, gold and foreign exchange reserves at the end of September totaled USD 35.6 billion, having decreased by USD 1.2 billion over the last month.

The decline in reserves was mainly due to a decrease in the value of the gold portfolio by USD 800 million amid a 4.6% fall in the price of the gold from USD 1,814 to USD 1,731 per ounce because of increase in Treasury yields and the strengthening of the USD.

Assets in freely convertible currency decreased by USD 446 million mainly due to a decrease on correspondent accounts balances of second-tier banks, as well as the payment related to government debt, which amounted to USD 95 million in September.

Factors that influenced volume of foreign exchange assets of the National Fund in September

According to operational data at the end of September, the foreign exchange assets of the National Fund amounted to USD 55 billion, having decreased by USD 1.9 billion over the month.

During the period, guaranteed and targeted transfers to the government budget amounted to 392 billion tenge. In order to facilitate the transfers, FX assets worth of USD 913 million were sold. At the same time, receipts to the fund in September in foreign currency amounted to USD 259 million.

As I have already noted, in the past month we have witnessed a significant correction in the financial markets. On the backdrop of capital outflow into money market instruments, there was a simultaneous decrease in the value of both risky and defensive assets: shares, corporate bonds, and gold fell. The prices for bonds of developed countries also fell slightly. As a result, investment return for September was negative 2.11% (USD 1.2 billion), due to a decline in the stock market by 4.1%, bonds – by 1.3% and gold – by 4.6%.

It is important to note that the simultaneous decline in prices for all asset classes is short-term, and in the long-term, the strategic allocation of the National Fund's assets balances risks. Since the beginning of October, the stock market has partially recovered, the S&P 500 index rose by 2.14%, the MSCI World stock index of developed countries - by 1.33%. The strengthening of the US dollar has peaked,

supporting the gold price, which is up 1.67% since the beginning of the month. As of October 11, the investment return of the National Fund since the beginning of the month amounted to USD 250 million.

The prospects of foreign markets in the IV quarter and its impact on tenge

Global financial markets remain exposed to risks associated with the pandemic and tightening of monetary policies of the central banks of developed countries. This continues to put pressure on the currencies of emerging markets in general and on the tenge in particular.

Despite progress on the Covid-19 situation, there are concerns about a new rise in incidence rate with the onset of cold weather and virus season in the coming months. At the same time, the continuation of the vaccination process should contain the new wave to some degree. Goldman Sachs estimates that about 70% of the population in the US, UK and Eurozone has immunity from serious illness and hospitalization.

The winding down of quantitative easing programs is the first sign of tightening monetary policies of the world's leading central banks, which could also provoke a new outflow of capital from developing countries to developed ones.

On the other hand, given the forecasts of a cold winter and the growing demand for energy, oil prices are expected to rise further. Investment bank analysts believe that the rally in oil will continue in the next couple of months and expect it to stay above USD 80 per barrel by the end of the year. Replenishing the gas shortage and increasing production by OPEC + may become factors of volatility in the oil market.

Domestic factors such as recovery in economic activity, increased imports and continued fiscal impulse will continue to weigh on the tenge. Despite the rise in oil prices, the growth in the supply of foreign exchange is notably slower than the rapid growth in demand for it.

An additional source of foreign currency supply is the inflow of non-residents to the market for debt securities denominated in tenge. The National Bank, together with the Ministry of Finance, continues to work on the globalization of the government securities market of the Republic of Kazakhstan. The investments of non-residents in government securities of the Republic of Kazakhstan, despite significant outflows from emerging markets in September, remained stable - 789 billion tenge at the end of the month, having decreased over the month by only 5 billion.

The recognition of the debt market of Kazakhstan by foreign investors is also increasing. FTSE Russell, following the results of the annual country assessment of the bond market, announced the inclusion of the government securities market of the Republic of Kazakhstan in the FTSE Frontier Emerging Markets Government Bond Index. Government bonds of the Republic of Kazakhstan will be included in the

index starting from April 2022. This indicates the growing interest and attention of international investors. The next step for the development of the market should be to meet the requirements of the bond index of developing countries, which serves as a benchmark for a wider range of investors and international funds.