RESEARCH SECTOR

Money Market Updates

Stepping into 2H19

For targeted recipients only

June 2019

Key factors driving financial markets

US-China trade disputes	US-Iran tensions	US-Turkey tensions	Federal reserve policy decision	Brexit	US sanctions on Russia	OPEC meeting
The decision over additional tariffs on remaining Chinese imports of USD300bln is still under consideration.	Tensions mounted after Trump blamed Iran for a pair of attacks on oil tankers in the Persian Gulf and Iran shot down a US Navy drone.	Dispute over Ankara's plans to acquire a Russian air defense system, just ahead of its expected July delivery.	Next FOMC meeting will be held 30-31 July.	Boris Johnson, the front-runner to be Britain's next prime minister, pledged to leave the EU on 31 Oct. without a transition deal if necessary.	On 21 June a bloc of centrist US House Democrats threw their support aimed at securing future US elections and punishing Moscow for its alleged political interference in 2016.	OPEC, allies meet to set policy on 1-2 July

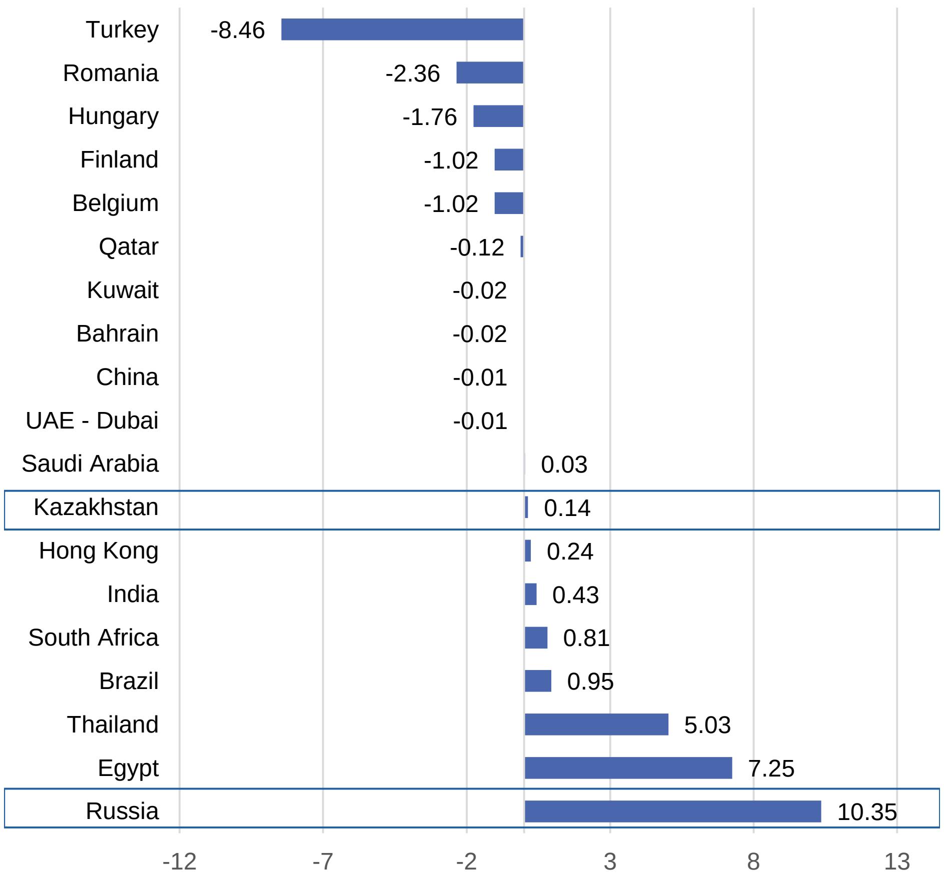
What to expect soon:

- On 26 June 2019, the US stated it would suspend the next round of tariffs on an additional USD300bln of Chinese imports while Beijing and Washington prepare to resume trade negotiations, according to market sources (source: Bloomberg). The decision might be announced after the meeting between Presidents Donald Trump and Xi Jinping set for Saturday at a Group of 20 summit in Japan.
- The Turkish leader plans to discuss the S-400 purchase with Trump at the Group of 20 summit in Japan, and is counting on their personal rapport to fend off stinging sanctions.
- Special Counsel Robert Mueller has agreed to testify before two House committees on 17 July, the chairmen of the panels stated on 25 June, promising to reinvigorate the national debate over his findings on Russia election interference and possible obstruction of justice by Donald Trump. To recall, Mueller stated in his report that he couldn't conclude whether Trump's 2016 campaign conspired with Russia.
- At present, Iran is threatening to breach the landmark agreement by exceeding a cap on stockpiles of low-enriched uranium unless Europe takes action to alleviate the pressure of tightening US sanctions.
- On 25 June Federal Reserve officials pushed back on market expectations and presidential pressure for the central bank to deliver a significant US interest rate cut of half a percentage point as soon as its next meeting.
- Oil prices are still supported by geopolitical tensions between Iran and the US and by a rally in equities after the US Federal Reserve signaled it's ready to cut interest rates for the first time in more than a decade.

Source: Bloomberg, Samruk-Kazyna

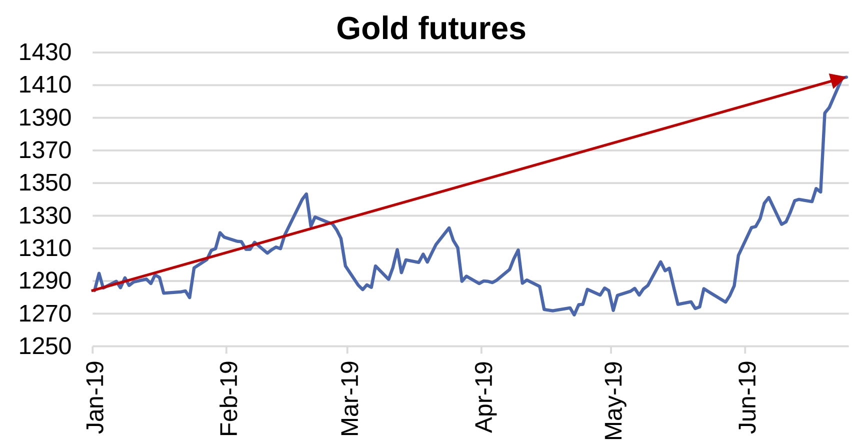
EM currencies showed a mixed picture in 1H19, with Russian ruble outperformed all emerging markets' currencies

YTD % change in currency values vs. USD as of 26 June 2019



Key highlights

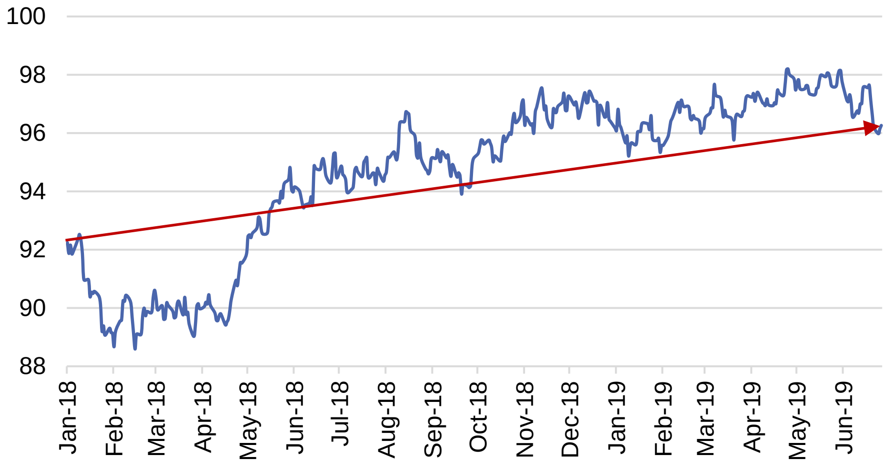
- In recent past major central banks adopted a more dovish stance, thus improving investors appetite for risky assets and supporting emerging markets' currencies.
- However, as geopolitical risks mount, most investors favor haven assets. This underpinned Yen vs. USD and pushed gold prices higher.
- JPY strengthened to 107.2 vs. USD on 25 June 2019, the highest level since mid-April 2018. Gold futures were trading at USD1,414.90 per ounce, the highest level since mid-2013.



Source: Bloomberg, Samruk-Kazyna

Markets seem convinced that Fed intends to cut interest rates in July

DXY Index



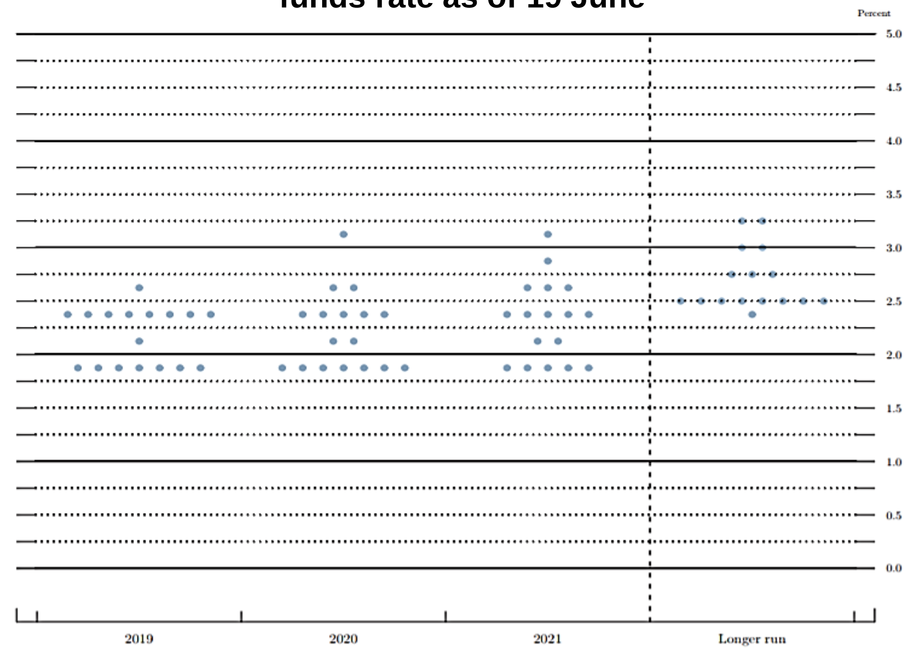
- The target range for the federal funds rate remained unchanged at 2.25% to 2.5% on 19 June. The Federal Reserve's dovish pivot unleashed a bearish tide against the US dollar.
- Market players expect interest rate cut as early as next month. Meanwhile, Federal Reserve considers whether uncertainties over US tariffs, conflicts with trading partners and tame inflation require a rate cut.
- On 25 June, Federal Reserve officials pushed back on market expectations for the central bank to deliver a significant US interest rate cut at the next meeting.
- The Federal Reserve's so-called dot plot, which the US central bank uses to signal its outlook for the path of interest rates, shows that policymakers are divided on policy for the remaining of this year.

Federal Reserve's economic projections as of 19 June

Indicators	2019	2020	2021	Longer-run
Change in real GDP	2.1	2.0	1.8	1.9
Unemployment rate	3.6	3.7	3.8	4.2
PCE inflation	1.5	1.9	2.0	2.0
Core PCE inflation	1.8	1.9	2.0	n/a
Federal funds rate	2.4	2.1	2.4	2.5

Market consensus: 100% implied cut probability during the meeting on 31 July (80%: 2-2.25%, 20%: 1.75-2%, current: 2.25 – 2.5%).
Economists: current: 2.5%, Sep 19: 2.25%, Dec 19: 2.0%.

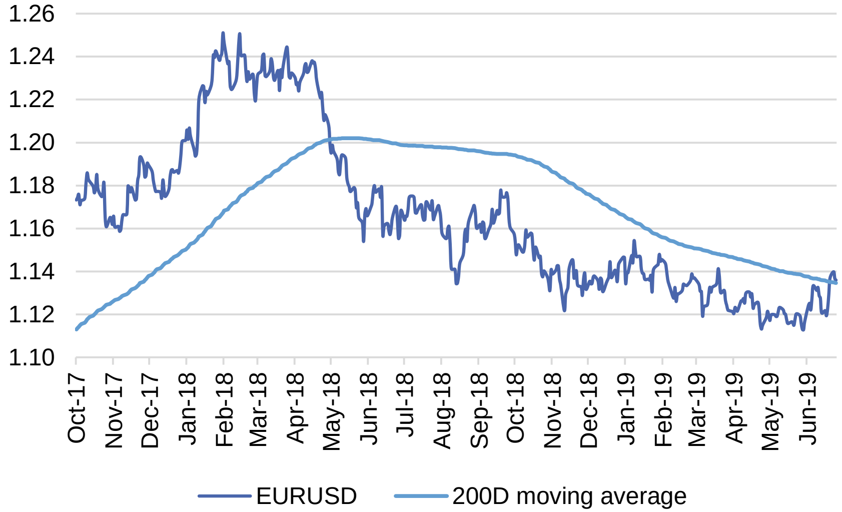
Midpoint of target range or target level for the federal funds rate as of 19 June



Source: Bloomberg, Samruk-Kazyna

ECB is expected to deliver an interest rate cut in September

EURUSD



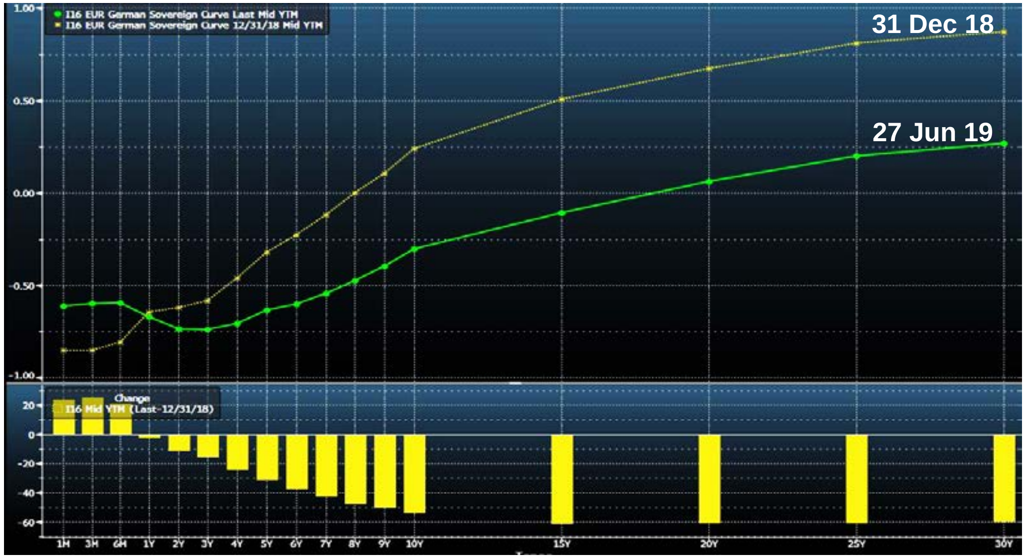
Market expectations over EURUSD

Market expectations	As of	3Q19	4Q19	1Q20	2Q20
Median of all investment banks	27.06.2019	1.13	1.15	1.16	1.17
Key investment banks' forecasts					
Barclays	26.06.2019	1.14	1.11	1.08	1.06
Wells Fargo	19.06.2019	1.13	1.14	1.15	1.16
ING Financial Markets	14.06.2019	1.12	1.15	1.16	1.17
JPMorgan Chase	10.06.2019	1.15	1.17	1.18	1.18
Morgan Stanley	05.06.2019	1.13	1.16	1.18	1.2

In-house estimate for EURKZT for 2019 is at 433 in mid-May 2019 based on ~KZT380 vs. USD and market-consensus over EURUSD (FX rate on 26 June: 431.85)

- USD was at 1.1369 vs. EUR on 26 June, having weakened by 0.9% YTD. 10-year German sovereign debt was priced at minus 0.332% on 25 June, the lowest level in history.
- The next policy meeting is on July 25. Implied market probability of a rate cut was at 63.9% for the meeting on 12 September 2019 (25 July: 36.9%). Current interest rate is -0.4% (deposit facility).
- Even if the ECB does follow through with a rate cut or the resumption of large-scale bond purchases, it might not be enough. Some investors fear that inflation is stuck chronically low and monetary stimulus simply risks pumping up already-pricey financial assets, potentially creating bubbles.
- Market players view that even with the ECB's loose monetary stance, the euro will probably strengthen against the dollar.

Yield curve based on German sovereign bonds



Source: Bloomberg, Samruk-Kazyna

Threat of fresh US sanctions has faded pushing ruble higher

USDRUB

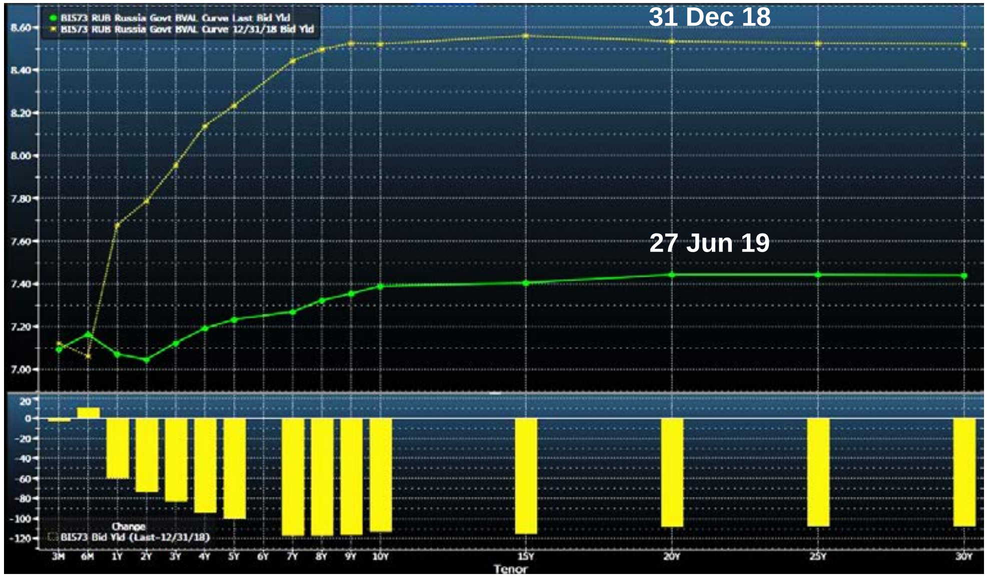
Market expectations over USDRUB

Market expectations	As of	3Q19	4Q19	1Q20	2Q20
Median of all investment banks	27.06.2019	65	66	66	66.75
Key investment banks' forecasts					
Barclays	26.06.2019	64.5	66	66.5	67
Wells Fargo	19.06.2019	64.5	64.25	64.25	64
ING Financial Markets	14.06.2019	67	66	67	68
JPMorgan Chase	10.06.2019	67	67	67	67
Morgan Stanley	05.06.2019	63	62	61	60

Based on current market dynamics estimate for RUBKZT was at 5.8 for 2019 in mid-May 2019 (FX rate on 26 June 2019 was at 6.0432).

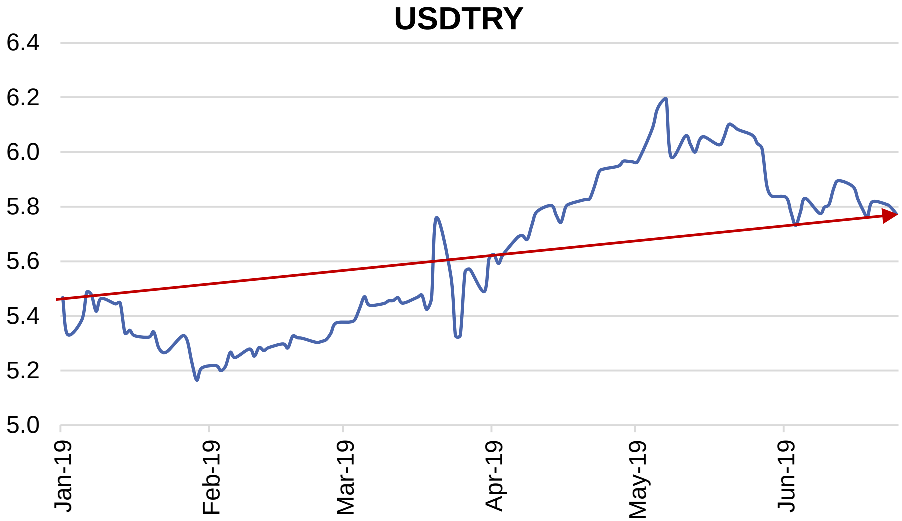
- USDRUB was at 63.0514 as of 26 June, having strengthened by 10.4% YTD, outperforming all other emerging markets, as sanctions threat faded.
- 10-year RUB government bond was trading at 7.385%, the lowest since June last year, reflecting (1) the release of Special Counsel Robert Mueller's report, (2) faded threat of US sanctions on new sovereign bonds, (3) the main focus of US on tensions with China.
- Russia joined other emerging markets by lowering interest rates. Central Bank of Russia signaled more cuts to come. Current key interest rate is 7.5% (14 June: -25bps).
- On 21 June, the ruble and government bonds took a tumble as a group of Democrat lawmakers proposed sanctions on Russian sovereign debt. After initially slumping, the ruble trimmed losses as investors digested the news. The proposed penalties on Russia so far made little progress in Congress.

Yield curve based on Russian sovereign bonds



Source: Bloomberg, Samruk-Kazyna

Political risks weigh on lira

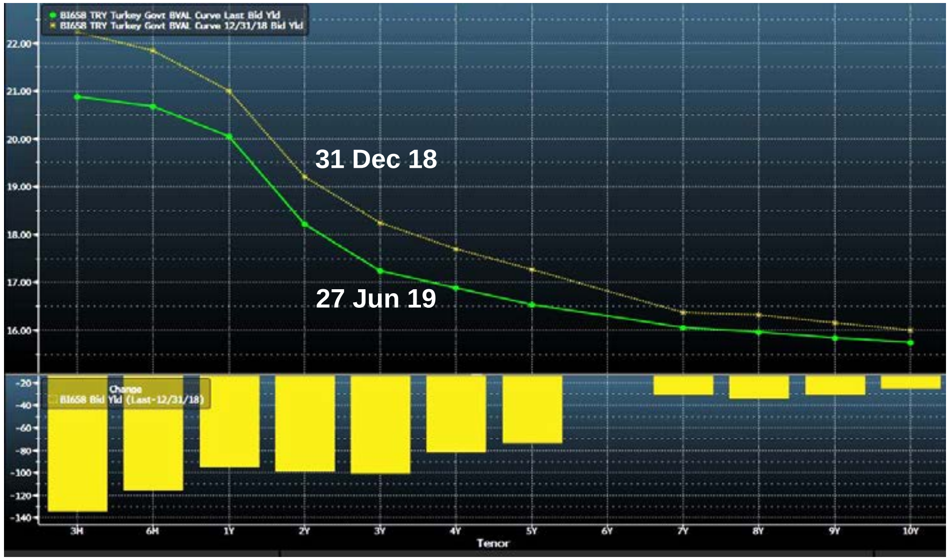


Market expectations over USDTRY

Market expectations	As of	3Q19	4Q19	1Q20	2Q20
Median	27.06.2019	6.2	6.2	6.28	6.39
Key investment banks' forecasts					
Barclays	26.06.2019	6	6.2	6.4	6.5
JPMorgan Chase	10.06.2019	6	6.35	6.65	6.9
Morgan Stanley	05.06.2019	6.7	6.75	6.8	6.9
Raiffeisen	31.05.2019	5.9	5.8	5.93	6.06
Standard Chartered	31.05.2019	5.6	5.7	5.8	--
Societe Generale	30.05.2019	6.4	6.6	6.7	6.8

- TRY was at 5.77 vs. USD, having weakened by 8.5% YTD. Turkey sovereign TRY bond was trading at 15.77% on 24 June 2019, the lowest level since mid-July 2018.
- Current central bank's interest rate is at 24% (1-week repo rate). Inflation was at 18.71% in May vs. 20.3% in December 2018.
- The prospect of the US sanctions over the country's planned purchase of a Russian missile-defense system weighs on the lira. On 27 June, Turkish President has downplayed the threat of US sanctions by saying that he never got the sense from speaking with the US President that Ankara could be punished for purchasing a Russian missile system (source: Bloomberg). Market players expect the outcome of the Turkish President's meeting with Donald Trump at the G-20 summit in Japan.

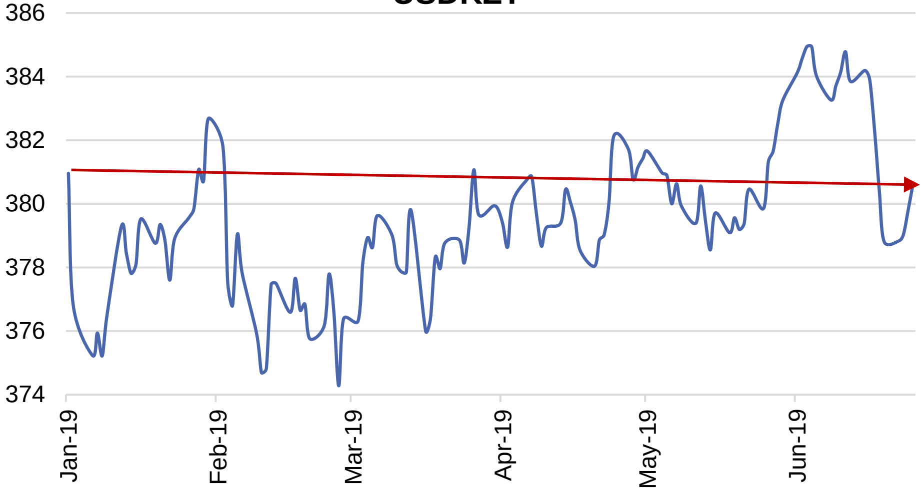
Yield curve based on Turkey sovereign bonds



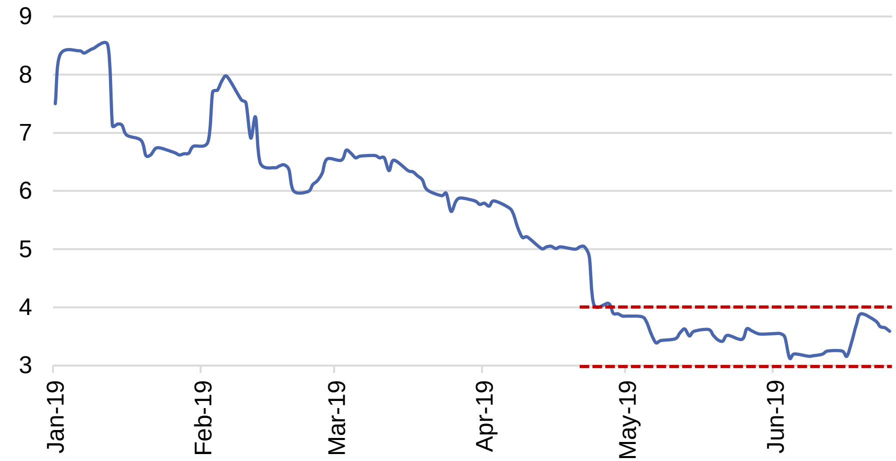
Source: Bloomberg, Samruk-Kazyna

USDKZT remained unchanged, volatility of USDKZT subdued, while short-term interest rates rose in 1H19

USDKZT

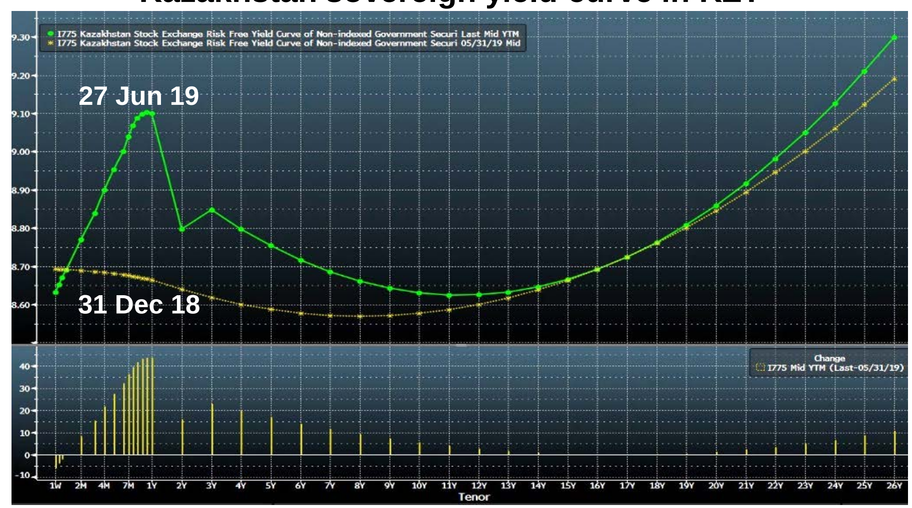


Historical 30-day volatility, %



- USDKZT was at 379.85 on 27 June, having strengthened by marginal 1.1% YTD. Meanwhile, 30-day historical volatility eased to a low of 3.16% on 18 June. On 26 June the indicator was at 3.65%.
- 1-year NBK's note was trading at 9.10% on 27 June vs. 8.78% on 21 June. This is the highest level starting from 30 June 2018, when the data became available on Bloomberg. As of 31 May, the share of foreigner holdings was 3%, which is KZT115bln (12 April 2019: KZT118bln). This compared to the highest level of KZT454bln on 1 March 2018.
- On 7 June 2019, NBK pointed out that fundamental factors remain strong, including current account balance and growing international reserves. NBK kept the base rate unchanged at 9% on 3 June 2019, with the balance of risks is shifting to a higher rate trajectory. Next meeting will be on 15 July.

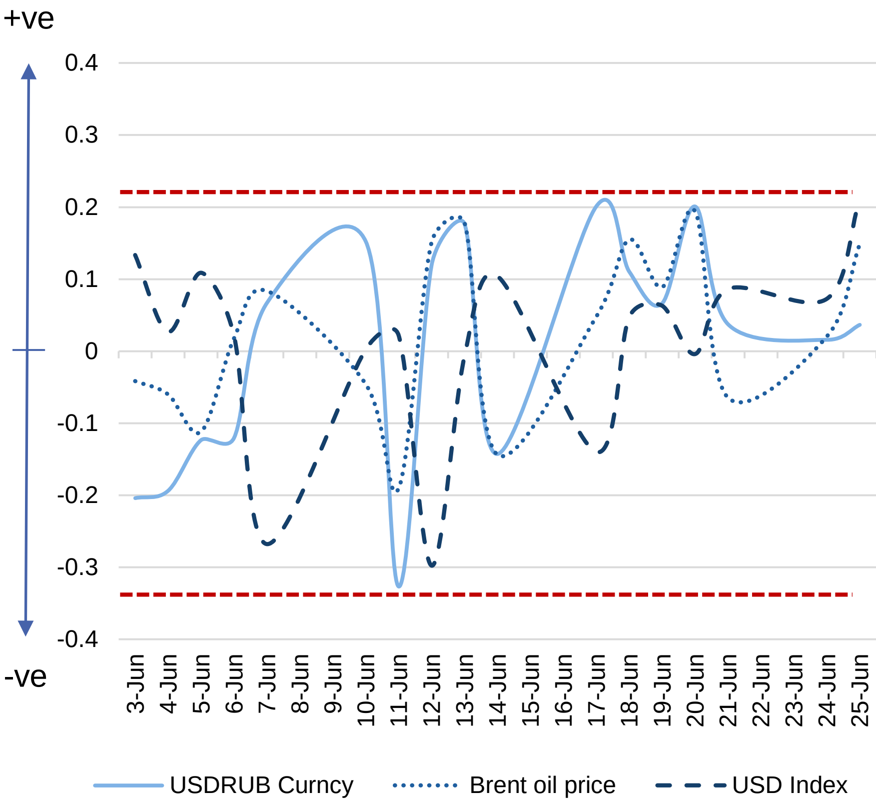
Kazakhstan sovereign yield curve in KZT



Source: Bloomberg, National Bank of Kazakhstan, Samruk-Kazyna

Market players expect USDKZT to hover at 380.6 – 385.2 in the next month

60-day historical correlation of KZT vs. USDRUB, Brent, DXY Index



Short-term local market expectations (for July 2019)

Source	Average for USDKZT	Median for USDKZT
Financial market participants, representatives of banking, insurance, broker, analytical and treasury structures	380.6	380
Association of Financiers of Kazakhstan	385.2	385
Analysts' Agency "Valuta"	382 - 382.5	n/a

- Overall market players expect USDKZT to seesaw in a range of between 380.6 – 385.2 in July. We estimate USDKZT at 379.5 for 2019.
- We view that since Kazakhstan is a frontier market (with a still underdeveloped stock exchange and currency market), USDKZT has lower correlations with global markets vs. emerging and developed markets. That said, narrow trading in USDKZT with few market players is subject to abrupt shifts in demand/supply.
- As of 25 June, correlations numbers are 0.037, 0.149 and 0.211 for USDRUB, Brent oil price, and DXY Index (USD vs. the basket of currencies), respectively, thus implying a lack of common tendencies. However, it should be noted, that historically Brent crude and USDRUB are key factors driving USDKZT dynamics.
- Although USDKZT is supported by strong macroeconomic fundamentals, sudden adverse shifts in market sentiment that become self-fulfilling prophecies and contagion from FX slump in other countries might negatively affect USDKZT dynamics moving forward. Theoretically, the weaker banking sector might also contribute to potential USDKZT weakening.

Source: Bloomberg, Samruk-Kazyna

Conclusion

- ✓ Uncertainty about trade and geopolitics is weighing heavily on market sentiment. Investor universe awaits for the outcomes of G-20 meeting in Japan this weekend. Economists indicated a 50% probability of the US and China agreeing at G-20 meeting to resume trade talks. Market players will eye the meeting of Turkish President and the US President and clarification on the US potential sanctions on Turkey.
- ✓ Market players expect the Federal Reserve to cut interest rates during the next meeting at end-July, as the US-China trade disputes take a toll on the global economy. That said, economists surveyed during 20-24 June expect interest rate cuts multiple times this year (current: 2.5%, Sep 19: 2.25%, Dec 19: 2.0%), this is more cautious compared to investors betting that easing cycle will start in July. However, expectations over the Fed's monetary policy is subject to the progress in resolving disputes with major US trading partners.
- ✓ The ECB is increasingly concerned that external factors, especially the US–China trade disputes, might threaten a sustained return of inflation to its target (target inflation: 2%, May 2019: 1.2%). Most economists expect (1) the ECB will change its policy language at the meeting on 25 July to show that rates might fall, and (2) the deposit rate to be reduced by 10bps to minus 0.5% in September. Meanwhile, it is still uncertain whether ECB will resume large-scale asset purchases any time soon. At present, Eurozone's economic confidence slid to the lowest level since 2016 amidst deepening trade tensions and a more cautious outlook for global economic growth.
- ✓ Central Bank of Russia turned dovish, indicating two more cuts this year (currently: 7.5%). This implies shifted priorities to focus on economic growth, as the regulator stated GDP growth missed forecasts. CBR views that tapping national wealth fund to finance stimulus projects might lead to higher inflation (target inflation: 4%, inflation in May: 5.1%). USDRUB was the best performer in 1H19, as sanctions threat faded. On 21 June, the new sanctions on sovereign debt, banks, and Russian-backed LNG projects were proposed by the Blue Dog Coalition, a group of centrist Democratic lawmakers. That said, Democrats do not have a majority in Senate and the proposals would have to win Republican support to pass (source: Bloomberg).
- ✓ USDKZT stopped to mirror USDRUB and Brent crude, with correlations seesawing close to the neutral level. Meanwhile, 30-day historical volatility remains low and USDKZT strengthened marginally in 1H19. However, the short-term yields on NBK's bonds with maturities up to one year trended upward, as the balance of risks is shifting to a higher rate trajectory.

Thank you

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