

Kazakhstan's CDS and bond yields on the rise

Tenge has weakened by 1.5% in the past two weeks to 340.4/USD on 21 September. NBK expects tenge to remain stable in the coming months, with no fundamental reasons for significant fluctuations. Meanwhile, emerging markets' currencies were suppressed by market expectations of the Federal Reserve's decision to put its crisis-era stimulus program into reverse. In addition, the Federal Reserve's decision affected yields of sovereign bonds, as well as interest rates on CDS in Kazakhstan, Russia, China, as well as major economies in Eurozone.

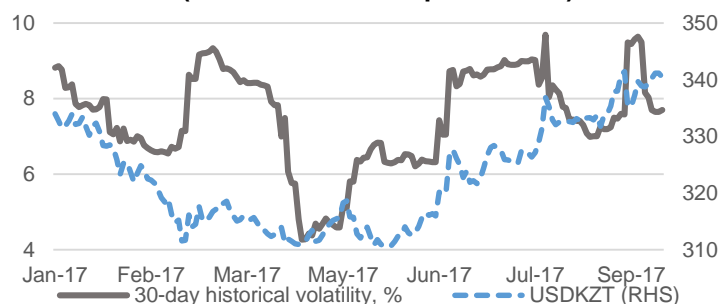
- Tenge has weakened by 1.5% in the past two weeks to 340.4/USD on 21 September. Today, USDKZT settled at 340.1. Meanwhile, oil prices reached the highest level since mid-April 2017 of USD56.4pb on 21 September. The oil price growth had a limited impact on tenge, given an unusual positive 60-day correlation.
- The recent weakening of tenge was driven mainly by speculative factors, as well as the reluctance of exporters (mining/metallurgical and oil companies) to supply FX liquidity to Kazakhstan's currency market. This happened despite an increase of their oil, iron ore and others outputs. Thus, any shifts in demand or supply of the currency significantly affects the narrow FX market.
- Meanwhile, the ruble has weakened by 2.1% to 58.1/USD, in line with the negative trend of other emerging markets' currencies vs. USD. This was on the back of market expectations of the US Federal Reserve's decision to put its crisis-era stimulus program into reverse. In addition, the Federal Reserve's decision affected yields of sovereign bonds, as well as interest rates on CDS in Kazakhstan, Russia, China, as well as major economies in Eurozone.

FX market	21-Sep-17	7-Sep-17	22-Aug-17
USDKZT	340.4	335.4	332.9
EURKZT	405.6	404.4	391.7
RUBKZT	5.9	5.9	5.6
EURUSD	1.2	1.2	1.2
NDF USDKZT 1W, %	9.0	9.4	9.1
NDF USDKZT 1M, %	7.6	9.0	8.8
NDF USDKZT 3M, %	9.0	9.3	8.5
USDKZT 30D historical volatility	7.7	9.5	7.0
Money Market	21-Sep-17	7-Sep-17	22-Aug-17
TONIA, %	9.2	9.3	9.3
TONIA volume, KZT bln	336.4	375.0	357.2
TWINA, %	10.0	9.0	9.0
TWINA volume, KZT bln	5.4	0.7	3.4
SWAP 1D, %	n/a	9.4	9.2
SWAP 1D volume, USD mln	n/a	90.0	78.0
SWAP 2D, %	9.2	9.5	9.3
SWAP 2D volume, USD mln	313.5	309.0	237.4
MM Index, %	9.2	9.3	9.3
MM Index volume, KZT bln	374.7	405.6	383.2
Base rate, %	10.3	10.3	10.3
KazPrime 3M, %	11.3	11.3	11.4
KASE indices	21-Sep-17	7-Sep-17	22-Aug-17
KASE Index	2,025	1,960	1,925
KASE BY, %	9.2	10.1	9.8
NBK open position	21-Sep-17	7-Sep-17	22-Aug-17
Standing facility, KZT bln	-510	-367	-333
Open market operations, KZT bln	-2,681	-2,870	-2,874
Other operations, KZT bln	1,578	1,578	1,567
NBK's net position, KZT bln	-1,613	-1,658	-1,639
Correspondent accounts	169	151	188
Credit&Deposit rates	Jul-17	Jun-17	May-17
Corporate KZT loans rate, %	13.7	14.0	13.3
Retail KZT loans rate, %	18.7	18.6	18.6
Corporate FX loans rate, %	6.9	6.5	6.3
Retail FX loans rate, %	12.0	14.1	13.3
Corporate KZT deposits rate, %	8.0	8.2	8.7
Retail KZT deposits rate, %	11.9	12.1	12.0
Corporate FX deposits rate, %	1.5	1.8	1.6
Retail FX deposits rate, %	2.3	2.3	2.2

Source: Bloomberg, KASE, NBK, Samruk-Kazyna

Tenge has weakened by 1.5% in the past two weeks to 340.4/USD on 21 September. On 6 September, USDKZT settled at 341.1, erasing gains since mid-November. Meanwhile, the 30-day historical volatility of USDKZT slid to 7.7% on 21 September from 9.5% on 7 September.

**The 30-day historical volatility of USDKZT, %
(1 Jan 2016 – 21 September 17)**



Source: Bloomberg, Samruk-Kazyna

Meanwhile, the ruble has weakened by 2.1% to 58.1/USD in the past two weeks, in line with other emerging markets' currencies, namely South African rand, Brazilian real, Mexican peso, Turkish lira, as well as Chinese renminbi, amidst market expectations of the US Federal Reserve's decision to put its crisis-era stimulus program into reverse.

On 20 September 2017, the US Federal Reserve has decided to maintain its benchmark interest rate at the current level, but the regulator is widely expected to consider one more interest rate hike later this year. At the same time, the Fed announced that it would start paring back its USD4.5tn balance sheet in October. We view rising interest rates in the US might pose a threat to emerging markets since investors would be more inclined to invest in USD assets in the long-term.

FX rates (Sep 2016 – Sep 2017)

Per 1 US dollar	21-Sep-17	1D Δ	1M Δ	6M Δ	1Y Δ
Kazakh tenge	340	0.2%	-2.2%	-7.2%	-0.9%
Russia ruble	58.1	0.2%	1.7%	-2.0%	10.1%
Chinese renminbi	6.60	-0.3%	1.0%	4.4%	1.1%
Euro	0.84	0.2%	1.3%	10.3%	5.9%
British pound	0.74	0.1%	5.3%	8.3%	4.1%
Swiss franc	0.97	-0.3%	-0.5%	1.9%	-0.4%
Czech koruna	21.9	0.2%	1.3%	14.3%	9.6%
Turkish lira	3.51	-0.1%	-0.4%	3.0%	-15.0%
Australian dollar	1.26	-1.3%	0.2%	4.0%	3.9%
Canadian dollar	1.23	-0.2%	1.7%	8.3%	7.1%
Japanese yen	112	-0.1%	-2.4%	-0.9%	-10.7%
Mexican peso	17.8	-0.4%	-1.0%	5.1%	11.4%
Brazilian real	3.13	0.1%	1.1%	-0.7%	3.6%
South African rand	13.3	0.0%	-0.7%	-6.6%	2.7%
DXI Index	92.4	-0.2%	-1.3%	-7.3%	-3.1%

Source: Bloomberg, Samruk-Kazyna

Following the Federal Reserve's decision, the dollar Index (DXY Index), which measures the US currency against a basket of its peers, has pulled back from a more-than-two-week peak as bets stoked by the Fed's signal on rates abated. The dollar index fell 0.2% to 92.4. Meanwhile, the ruble is being supported by the month-end tax payments by exporters (main tax payments are due on 25 September). Thus, the ruble vs. the US dollar has strengthened by 0.2% to 58.1 on 21 September compared to the previous closing level.

The Fed's decision affected sovereign bond yields, as well as sovereign CDS. CDS is a credit derivative contract that protects lenders in the event of default through transferring the risk in return for periodic payments. That said, the yield on Kazakhstan's sovereign international bond with maturity in 2015 and coupon rate of 6.5% rose by 4.1bps to 4.9% on 21 September compared to the previous trading day.

Yield to maturities of sovereign bonds, % (Sep 2016 – Sep 2017)

	21-Sep-17	1D Δ, bps	1M Δ, bps	6M Δ, bps	1Y Δ, bps
USD Kazakhstan 6.5% '45	4.9	4.1	-16.2	-43.2	3.7
EUR Germany 0.5% '27	0.5	1.5	5.7	5.5	57.3
RUB Russia 8.15% '27	7.6	5.0	-20.0	-39.0	-61.0
EUR France 1% '27	0.7	0.9	3.3	-24.6	55.6
CNY China 3.59% '27	3.6	1.6	-1.8	40.3	93.2
EUR Italy 2.2% '27	2.1	4.0	1.4	-10.3	92.0
EUR Netherlands 0.75% '27	0.6	1.2	4.8	-6.4	58.2
GBP UK 4.25% '27	1.4	3.8	29.1	18.1	67.9
TRY Turkey 10.5% '27	10.7	11.0	32.0	16.0	110.0
CZK Czech 2.5% '28	1.1	3.1	21.7	24.8	95.5
USD US 2.375% '27	2.3	-1.1	4.0	n/a	n/a

Source: Bloomberg, Samruk-Kazyna

Similarly, interest rates on sovereign CDS saw a spike on Wednesday. Kazakhstan's 5-year CDS rose by 9.2bps to 135bps on 21 September in the past two days, as the Fed reinforcing another 25bps hike this year is seen as an external risk as it could mean higher bond yields and weaker regional currencies.

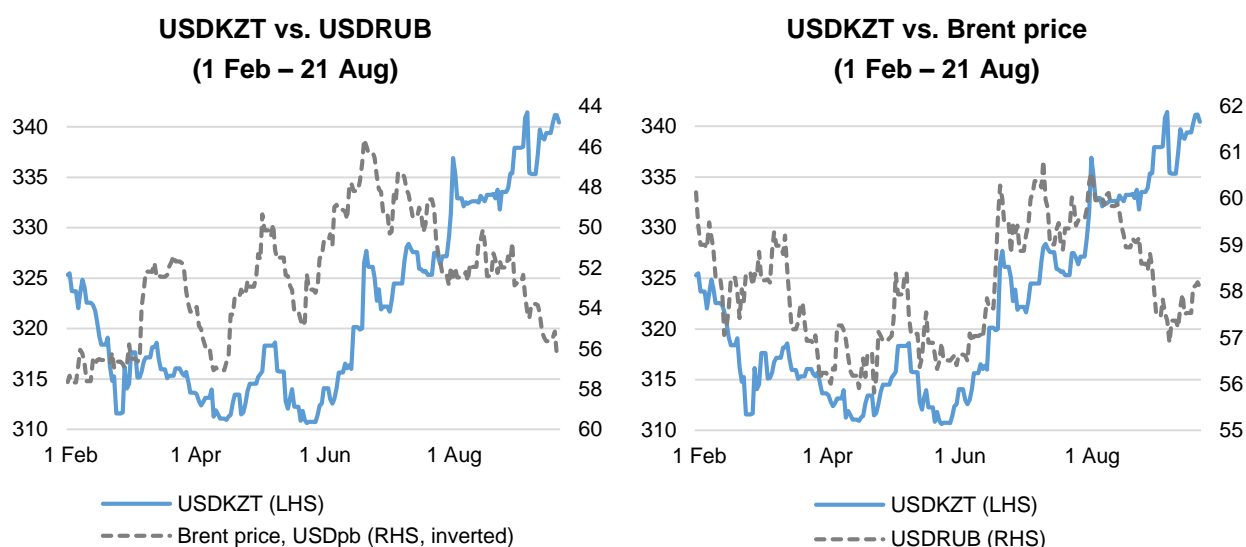
Dynamics of CDS spreads, bps (Sep 2016 – Sep 2017)

	21-Sep-17	2D Δ, bps	1M Δ, bps	6M Δ, bps	1Y Δ, bps	S&P Moody's Fitch
Kazakhstan CDS 5Y	135	9.2	-1.4	-27	-56	BBB- Baa3 BBB
Russia CDS 5Y	150	14.6	2.5	-21	-63	BB+ Ba1 BBB-
China CDS 5Y	58	5.5	-6.2	-25	-47	A+ A1 A+
Germany CDS 5Y	13	1.3	-0.8	-5.5	-6.0	AAAu Aaa AAA
Italy CDS 5Y	143	13	-3	-40	1.4	BBB-u Baa2 BBB
Netherlands CDS 5Y	17	1.8	-0.3	-7	n/a	AAAu Aaa AAA
France CDS 5Y	21	1.9	-4.9	-25	-8	AAu Aa2 AA
UK CDS 5Y	24	1.2	5.4	n/a	-9	AAu Aa1 AA
Turkey CDS 5Y	186	21.0	11.3	-48	-77	BBu Ba1 BB+

Source: Bloomberg, Samruk-Kazyna

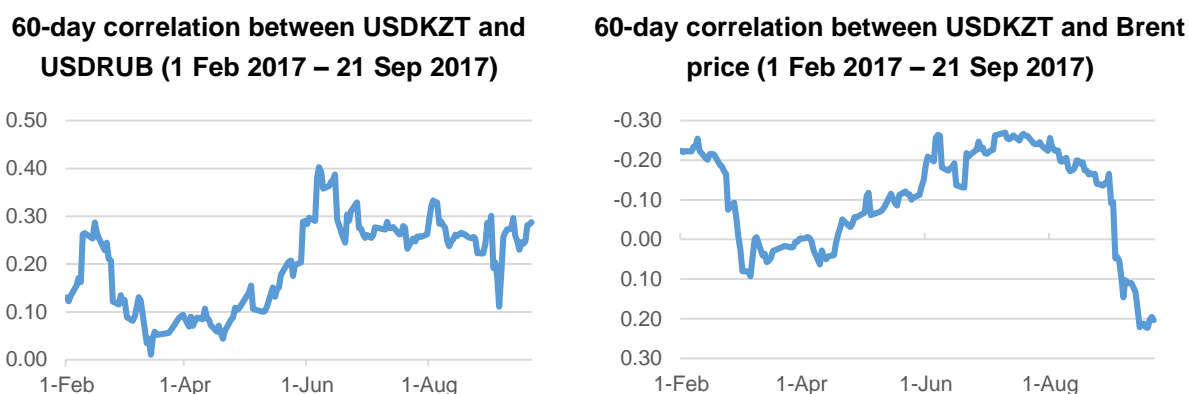
On oil markets, Brent crude oil showed an increase by 3.1% to settle at USD56.2pb, reaching the highest level since mid-April 2017. Investors awaiting to see whether major oil producers would extend supply cuts beyond March 2018 at a meeting in Vienna later on 22 September 2017. Talks and expectations over extending oil

production cuts are noteworthy but premature at this juncture. We think OPEC is unlikely to recommend extension of cuts at its meeting this week. Instead, there will be some focus on whether Nigeria and Libya, who have been exempt from the curbs, will join any future cuts.



Source: Bloomberg, Samruk-Kazyna

We view that oil prices have limited impact on USDKZT, given an unusual positive correlation of 0.29 on 21 September. Meanwhile, the correlation between USDKZT and USDRUB was hovering in the range of between 0.23 and 0.30 in the past two weeks, indicating a remaining influence of the ruble on tenge.

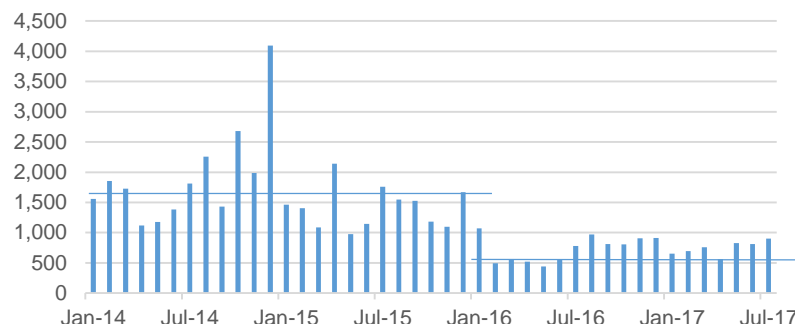


Source: Bloomberg, Samruk-Kazyna

The market saw a significant weakening of tenge despite a strengthening of the ruble and increase in oil prices. According to NBK, this was driven by speculative factors, as well as the reluctance of exporters (mining/metallurgical and oil companies) to supply FX liquidity on Kazakhstan's currency market, despite an increase in oil production. Exporters sold USD40bln (70% of trading volumes in USDKZT) in 2013, higher compared to USD10bln in 2016 (33%), given a decrease in FX revenues as well as a keeping FX liquidity abroad. Thus, any shifts in demand or supply of the currency significantly affects the narrow FX market.

Meanwhile, households contribute a small share in the total volume of transactions with FX in 2016-2017. Households have purchased FX of USD14bln in 2016 and 7M17, significantly lower compared to USD41bln in 2014-2015.

**FX purchases by households in exchange, USD mln
(Jan 2014 – Jul 2017)**

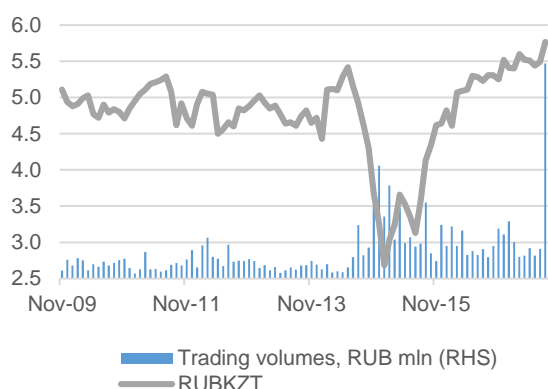


Source: NBK, Samruk-Kazyna

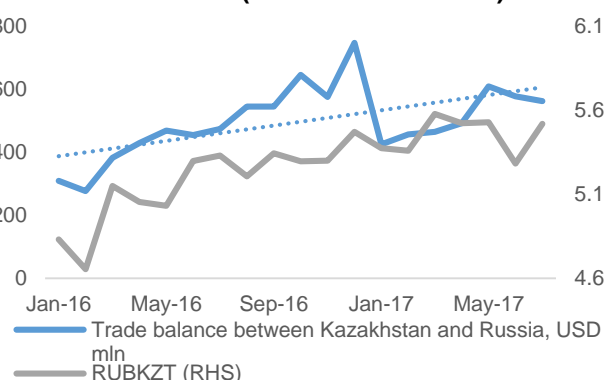
The market expects tenge to remain stable in the coming months, determined by fundamental factors. In addition, it sees no reasons for significant fluctuations of the local currency. At present, the situation on foreign markets remains favorable with oil prices seesawing above USD50pb and the economic growth of trading partners (Russia, China) gaining momentum. In addition, a significant improvement in the balance of payments in 1H17 constrains risks to the exchange rate policy. It is worth noting that movements in tenge reflect fundamental factors, namely the balance of payments, oil prices and developments in FX rates in main trading partners.

RUBKZT remains at 5.9, near a 19-year high. It is worth noting that NBK does not target any parity of RUBKZT. Recall, NBK stated that tenge as estimated as undervalued relative to the ruble, “which creates conditions for correction”. Meanwhile, an increase in RUBKZT could be attributable to developments in trade between Kazakhstan and Russia. Imports from Russia have the upward trend, boosting a demand for the ruble. Thus, if the economy does not generate enough export revenues, but has to pay for imports, there might be an imbalance in the foreign exchange market. It is worth noting, that the trading volume in RUBKZT has reached RUB6,785mln, which is more than 7 times higher compared to the previous month (July:RUB939mln).

RUBKZT (1 Jan 1998 – 21 Sep 2017)



**Trade balance between Kazakhstan and Russia
vs. RUBKZT (Jan 2016 – Jul 2017)**



Source: NBK, Bloomberg, Samruk-Kazyna

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