



## THE DEVELOPMENT OF THE EUR/KZT EXCHANGE RATE

According to the report published by the National Bank of Kazakhstan (NBK) on January 31, 2018, the investments in Euro done by individuals were the most profitable in national currency equivalent amongst other financial instruments in 2017. It was noted that individuals' deposits in Euro made about 15.3% income growth in 2017. Moreover, in 2017 keeping money in Euro without making any investments brought about 13.1% income growth. Meanwhile, deposits in U.S. dollars, Kazakh tenge, and Russian rubles brought about 1.7%, 14.9% and 13.4% income growth, respectively. Thus, the EUR/KZT exchange rate is gaining more interest among the population of the country, and it is important to look at its current and future dynamics.

In general, Euro is not very popular investment instrument among the country's citizens. For example, the share of the EUR/KZT trade in 2017 in the total currency trade on the Kazakhstan Stock Exchange (KASE) was only about 6.5%. Euro is not widely used despite the fact that European Monetary Union (EMU) countries are the main trade partners of Kazakhstan. For example, according to the Statistic Committee of the Ministry of National Economy of Kazakhstan in 2017, more than 43% of the country's total exports (\$20.97 billion) went to the EMU countries. Meanwhile, during the same period, the country's imports from the EMU amounted to \$4.41 billion, which is about 15.3% of the total imports of Kazakhstan. Overall, the EMU countries account for more than one third of the country's total trade turnover (32.7%), exceeding even the country's trade turnover with its fellow former Soviet Union countries, which accounted for 23.3% in 2017.

Due to the fact that Euro is not traded much in Kazakhstan, the EUR/KZT exchange rate is set by using a cross rate. For instance, the EUR/KZT exchange rate is set based on the rates of USD/KZT and EUR/USD exchange rates, meaning that the EUR/KZT exchange rate depends on the performance of tenge against U.S. dollar and performance of Euro against

U.S. dollar. Therefore, if Euro appreciates against U.S. dollar, the EUR/KZT exchange rate goes up, and if tenge appreciates against U.S. dollar, the EUR/KZT exchange rate goes down.

In 2017, the main factor of appreciation of tenge against Euro was the appreciation of the latter against dollar. For example, in 2017 the EUR/USD exchange rate went up by 13% to \$1.21 per €1. Meanwhile, during the same period, tenge appreciated against dollar by 0.3% to 332 tenge per dollar. Therefore, the EUR/KZT exchange rate went up because of good performance of Euro, which grew from 352 tenge per €1 in at the beginning of 2017 to 398 tenge per €1 at the end of 2017.

Euro appreciated against U.S. dollar due to several reasons. One of the main reasons was the announcement by Governor of European Central Bank (ECB) Mario Draghi that there might be some adjustments in the monetary policy of the ECB. It was assumed that the possible adjustments would be carried out in the form of closing of the Quantitative Easing (QE) program started by the ECB in 2014 to support the monetary union's economy. For instance, before the introduction of the QE program in 2014, the EUR/USD exchange rate was about \$1.4 per €1, however, after the introduction of the program, until the beginning of 2017 the EUR/USD exchange rate went down to \$1.01 per €1, reaching to \$1.2 per €1 in the end of the year. The closing of the QE program would mean shortening liquidity in Euro, which would lead to the appreciation of the currency. However, it is important to note that the QE program had not been closed in 2017. Another reason was the fact that EMU's economy had the highest growth rate in a decade in 2017, growing by 2.5%. It was the fastest growth rate since 2007, when the economy grew by 3.5%. It is worth mentioning that the 2017 growth rate was even higher than the rate expected by the European Commission.

As it was noted above U.S. dollar also depreciated against tenge in 2017. The depreciation of U.S. dollar against tenge was

mainly due to improving financial and economic situation in Kazakhstan. For example, inflation in 2017 was 7.1%, while it totaled 8.5% and 13.6% in 2016 and 2015, respectively. The country's real GDP growth was 4.0% in 2017, which was the highest rate since the oil price drop in 2014. In addition, the share of deposits in foreign currencies fell to 52.44% in 2017, while it was 62.24% and 79.13% in 2016 and 2015, respectively.

The EUR/KZT exchange rate in 2018 will also mainly depend on the USD/EUR exchange rate, because due to positive external and internal macroeconomic and political factors the USD/KZT exchange rate is not expected to change substantially. It is also expected that in the late 2018 the ECB will, after all, stop its QE program. In fact, the inflation in the EMU area reached 1.5% in 2017, which is close to the bank's target rate of 2%. For comparison, in 2016 and 2015 inflation rate in the Eurozone were 1.1% and 0.2%, respectively. Thus, to prevent inflation exceeding the ECB's target rate, the monetary authority will quite probably stop its aggressive bond buying program, since it is the main source of inflation in the region. As it was noted above, the end of the QE program will decrease Euro liquidity, which would lead to appreciation of the currency. Some analysts even expect that the EUR/USD exchange rate will reach \$1.3 per €1 in 2018.

Overall, if Euro is expected to appreciate against U.S. dollar from \$1.2 per €1 to \$1.3 per €1 (8%-9% appreciation) and the USD/KZT exchange rate is forecasted to remain unchanged in 2018, it is possible to suggest that in 2018 the EUR/KZT exchange rate will grow by 8%-9% to about 429-435 tenge per €1. Meaning that deposits in Euro in Kazakhstan will make about 9%-10% interest income in 2018. Meanwhile, currently, deposits in tenge are offering about 12% interest rate. Therefore, deposits in tenge quite probably will give higher return than in Euro in 2018, but if a person is looking for an investment in hard currency, Euro will be a better choice than U.S. dollar for 2018.

## Politics, Foreign Affairs and Security

- President of Azerbaijan Ilham Aliyev, President of Northern Cyprus Mustafa Akinci, President of Serbia Aleksandar Vucic, President of Ukraine Petro Poroshenko and President of Turkey Recep Tayyip Erdogan attended the inauguration ceremony of the TANAP project held in the city of Eskisehir, Turkey. The presidents stressed the significance of jointly developed energy projects for strengthening and expanding economic ties within the region.
- During the working meeting of experts of the Caspian states held in Astana, the participants discussed the preparation process for the upcoming summit of the heads of the Caspian states, which is planned to be held in August this year in Aktau, Kazakhstan.
- During his visit to Tashkent, Chief of the General Staff of the Armed Forces of Kyrgyzstan Rayimberdi Deyshenbiev met with Defense Minister of Uzbekistan, Major-General Abdusalom Azizov to discuss the current state and prospects for the development of Uzbek-Kyrgyz cooperation in the defense sphere. The sides exchanged views on strengthening mutually beneficial ties in the military direction. As a result of the meeting, the parties signed a military cooperation plan aimed to ensure regional security.
- The government of Azerbaijan announced its plans to increase the number of funds allocated for defense expenditures in the state budget for 2018 from 2.739 billion manats (\$1.608 billion) to 2.905 billion manats (\$1.716 billion). It was also noted that the funds provided for the defense forces would be increased from 1.366 billion manats (\$800 million) to 1.384 billion manats (\$802.3 million).
- During the visit to Dushanbe, Head of the National Security Service of Uzbekistan Ikhtiyor Abdullayev met with Head of the State Committee for National Security of Tajikistan Saimumin Yatimov to discuss issues of strengthening cooperation between the intelligence services of the two countries in the fight against terrorism, extremism, and transnational crime. As a result of the meeting, the parties signed an agreement on cooperation in the fight against international terrorism, protection of the state borders, and exchange of information.
- The Foreign Ministry of Turkmenistan reported that the country has been elected as a member of the UN Economic and Social Council for 2019-

2021. This decision was made during the 96th meeting of the 72nd session of the UN General Assembly.

## Economy, Finance and Energy

- According to Minister of Investments and Development of Kazakhstan Zhenis Kasymbek, in 2018 the country will put into operation 4,500 kilometers of roads, which is a record number. It was noted that during the past years the country puts 2,500 kilometers of roads into operation on average.
- According to the State Statistics Committee of Azerbaijan, the country's GDP volume reached almost 29.29 billion manats (\$17.2 billion) in January-May 2018, which is 1.1% more compared to the same period last year. In January-May 2018 the volume of GDP produced in the non-oil sector of the country increased by 1.9%, while no growth was observed in the oil and gas sector as compared to January-May 2017. The volume of GDP per capita stood at 2,991.1 manats (\$1,756.1).
- According to Chairman of the Central Bank of Azerbaijan (CBA) Elman Rustamov, the bank reduced the interest rate from 11 to 10%. The CBA also decided to reduce the interest rate cap from 14% to 12%.
- The government of Russia submitted a draft law on raising valued-added tax (VAT) from 18% to 20% to the State Duma. It was noted that the tax increase will allow the federal budget to receive additional 620 billion rubles (\$9.8 billion) a year beginning in 2019.
- According to the Employment Agency of Turkey, as many as 104,760 Turkish citizens were provided with workplaces in Turkey in May 2018. It was noted that 33% out of the total number of employed persons are women. A total of 2.561 million people were registered as unemployed in Turkey in May 2018.
- According to Minister of National Economy of Kazakhstan Timur Suleimenov, during the first five months of 2018 the country's GDP growth amounted to 3.9%. It was noted that economic recovery is taking place because of the increased investment activity and a slowdown in inflationary processes. During the reporting period, the inflation was fixed at 6.2%, which is the lowest value for the last three years.
- The Central Bank of Russia announced its decision to maintain the key rate at the level of 7.25% following the government's decision to raise the VAT and the growth in gasoline prices outstripping inflation in May 2018.

## Society and Culture

- The opening ceremony of the FIFA World Cup 2018 in Russia was attended by FIFA President Gianni Infantino, heads of state and government of Abkhazia, Armenia, Azerbaijan, Belarus, Bolivia, Kazakhstan, Kyrgyzstan, Lebanon, Moldova, Panama, Paraguay, Rwanda, South Ossetia, Tajikistan and Uzbekistan. Crown Prince of Saudi Arabia and Chairman of the Presidium of the Supreme People's Assembly of the DPRK also attended the event.
- According to the Department of Public Relations of the State Border Service of Kyrgyzstan, the checkpoints on the Kyrgyz-Chinese border was closed from June 15, 2018 to June 18, 2018 in connection with the celebration of Orozo Ait in Kyrgyzstan and Duanwu Festival in China.
- During his official visit to Tehran, Deputy Director of the Civil Aviation Agency of Kyrgyzstan Bakyt Dzhunushaliev met with Director for Public Relations of Iran's Civil Aviation Organization Reza Jafarzadeh to sign a memorandum of understanding for boosting cooperation in the field of air transport.
- During his official visit to Paris, Deputy Prime Minister of Uzbekistan Aziz Abdulkhaimov met with Director of the World Heritage Center Mechthild Rössler and Director of the Consultation and Monitoring Directorate of International Council on Monuments and Sites Regina Durigello to discuss topical issues of interaction between Uzbekistan and UNESCO. The sides also exchanged views on the prospects for implementation of joint projects, including the development of the UNESCO Country Program in Uzbekistan.
- According to the Uzbek state-owned railway carrier Uzbekistan Railways, the company carried over 9 million passengers in January-May 2018, which is 300,000 passengers more than in the same period of 2017. It was also noted that during the five months of 2018, Uzbekistan Railways transported nearly 28 million tons of cargo, exceeding the previous year's figure by 309,000 tons.
- The Russian government approved a bill on the gradual increase of the retirement age to 65 years for men and 63 years for women. Currently, the retirement age for men and women is 60 and 55 years, respectively. It was noted that the bill proposes to introduce a sufficiently long transition period starting from 2019 to gradually reach retirement age of 65 for men in 2028 and 63 years for women in 2034.