



Bank of Russia

No. 2

FEBRUARY 2019

BANKING SECTOR LIQUIDITY AND FINANCIAL MARKETS

Information and analytical commentary

Moscow
2019

Banking sector liquidity and financial markets: facts, assessments and comments (February 2019)

- In February, structural liquidity surplus rose amid seasonal funds inflow through the budget channel. Furthermore, the surplus temporarily increased as banks reduced their balances in correspondent accounts with the Bank of Russia as a result of an earlier-than-expected averaging of required reserves.
- Money market rates held somewhat below the Bank of Russia key rate. Rate reductions in certain periods were temporary in nature.
- The cost of FX borrowings remained low amid the seasonally high inflow in the current account of the balance of payments as fiscal rule-based currency purchases were moderate. The increase in long ruble position by non-residents failed to have a serious impact on FX liquidity in February.
- The optimistic sentiment seen in the Russian financial market in January eased somewhat in February. Other emerging market economies faced similar developments as investors had already overcome the softening of the US Fed's rhetoric and the progress in the trade negotiations between China and the US, while no other significant developments took place.
- The yield on long OFZ issues mostly grew throughout the month, which may be associated with concerns over sanction tightening. At the same time, foreign investors continued to purchase Russian sovereign bonds in February.
- In January-February 2019, rates on bank loans and deposits continued to rise at a moderate pace. The activity in key segments of loan and deposit markets in the opening months of 2019 remained virtually unchanged compared with the end of the previous year.

BANKING SECTOR LIQUIDITY AND MONEY MARKET

Ruble liquidity. In February, the structural liquidity surplus expanded by 0.9 trillion rubles to 3.6 trillion rubles. Such a sizeable change is associated with both the effect of liquidity factors, and the allocation of funds between banks' correspondent and deposit accounts with the Bank of Russia as of a certain date, and, therefore, is temporary in nature. The inflow of funds to banks largely resulted from the seasonal increase in budget expenditure with an almost neutral effect of cash in circulation (Chart 1). Furthermore, the increase in liquidity surplus in early March was associated with an early required reserves averaging by banks and the lack of need to keep funds in correspondent accounts after tax payments. This resulted in a decline in correspondent account balances, growth in the allotment amount at the Bank of Russia's weekly deposit auctions, and the need to conduct fine-tuning operations in periods

between tax payments and thereafter.¹ As a result, by the month-start the allotment amount at the Bank of Russia's deposit auctions had increased by 0.5 trillion rubles (Table 2).

Money market. Compared with the January required reserves averaging period, the spread between interbank rates and the key rate expanded somewhat by 7 bp to -22 bp (Chart 3). This was associated with the decline in the money market rates in the period before tax payments as Bank of Russia deposit auctions failed to attract enough funds. As a result, the volatility of money market rates increased somewhat.² The rate decrease was also triggered by the shrinking demand in the interbank segment as a result of redistribution of borrowings in the FX swap segment (see the *FX liquidity* section). This exerted a downward

¹ Fine-tuning auctions were held on 15 and 27 February, and on 1, 4 and 5 March, the allotment amount was 500, 317, 300, 770 and 860 billion rubles respectively.

² The standard spread deviation came in at 12 bp, which is 4 bp above the figures registered in the previous required reserves averaging period.

pressure on rates as the competition between borrowers in the interbank segment decreased somewhat.

FX liquidity. The interest rate spread in the interbank and FX swap (basis) segments remained slightly above zero, 15 bp on average. The basis volatility stood at 12 bp, remaining virtually unchanged compared with the previous averaging period.

The low cost of FX borrowings in the local market was underpinned by the seasonally high

inflow in the current account of the balance of payments as fiscal rule-based currency purchases were moderate. The effect of these factors on interest rates offset growth in long ruble positions of non-residents, i.e. increased their ruble placements and FX borrowings in the FX swap segment.

End-2019 forecast of the structural liquidity surplus has been kept at 2.8-3.3 trillion rubles.

THE INTEREST RATE PATH EXPECTED BY MARKET PARTICIPANTS DID NOT CHANGE SIGNIFICANTLY

Table 1

1. Expectations based on market indicators*, interest rate (instrument)	April 2019	July 2019
– MosPrime 3M (FRA)	8.69 (8.81)	8.85 (8.86)
– RUONIA (ROISfix)	7.68 (7.81)	7.92 (7.94)
– RUONIA (futures)	7.68 (7.86)	7.83 (7.97)
2. Analysts' expectations for the key rate*	As of 31 March 2019	As of 30 June 2019
– Bloomberg survey	7.75 (7.75)	7.75 (7.5)
– Reuters survey	7.75 (7.75)	7.75 (7.75)
3. Implied inflation rate (OFZ-IN)	February 2019	
– OFZ-IN-52001 (till 16 August 2023)	4.95 (5.11)	
– OFZ-IN-52002 (till 2 February 2028)	4.88 (4.91)	

* Data as of the end of previous month are given in brackets.

Source: Bank of Russia calculations.

END-2019 FORECAST OF THE STRUCTURAL LIQUIDITY SURPLUS HAS BEEN KEPT AT 2.8-3.3 TRILLION RUBLES (TRILLIONS OF RUBLES)

Table 2

	January-February 2019	February 2019	2019 (forecast)
1. Liquidity factors (supply)	0.3	0.3	[0.1; 0.6]
– changes in the balances of general government accounts with the Bank of Russia, and other operations*	-0.3	0.3	[0.6; 1.0]
– change in cash in circulation	0.5	0.0	[-0.6; -0.5]
– Bank of Russia interventions in the domestic FX market and monetary gold purchases**	0.1	0.1	0.1
– regulation of banks' required reserves with the Bank of Russia	0.0	0.0	0.0
2. Change in free bank reserves (correspondent accounts) (demand)	-0.2	-0.5	0.3
3. Change in banks' claims on deposits with the Bank of Russia and coupon OBRs	0.5	0.9	[-0.2; 0.3]
4. Change in outstanding amounts on Bank of Russia refinancing operations (4 = 2 + 3 - 1)	0.0	0.0	0.0
Structural liquidity deficit (+) / surplus (-) (as of the period-end)	-3.6		[-3.3; -2.8]

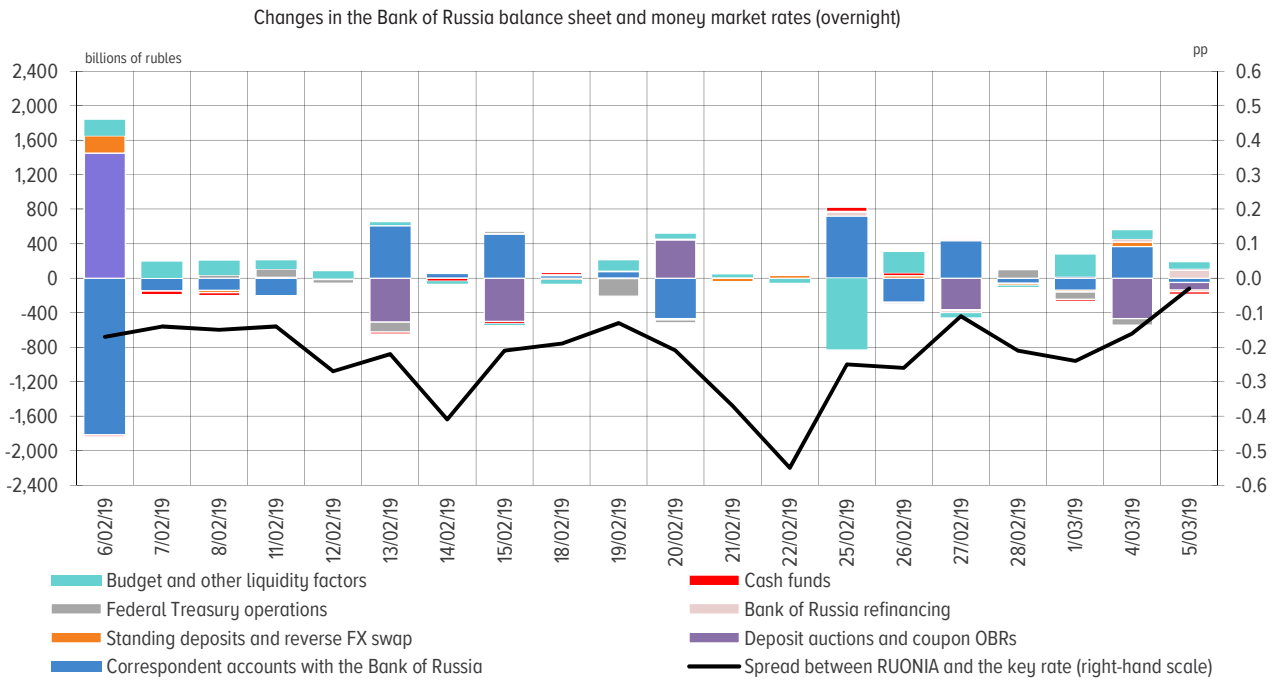
* Including operations to buy (sell) foreign currency in the domestic FX market under the fiscal rule, settlements on Bank of Russia USD/RUB FX swaps, and other operations.

** Forecast values of the indicator correspond to the actual volume of operations conducted.

Source: Bank of Russia calculations.

IN FEBRUARY 2019, THE INFLOW OF FUNDS TO BANKS LARGELY RESULTED FROM THE SEASONAL INCREASE IN BUDGET EXPENDITURE WITH AN ALMOST NEUTRAL EFFECT OF CASH IN CIRCULATION

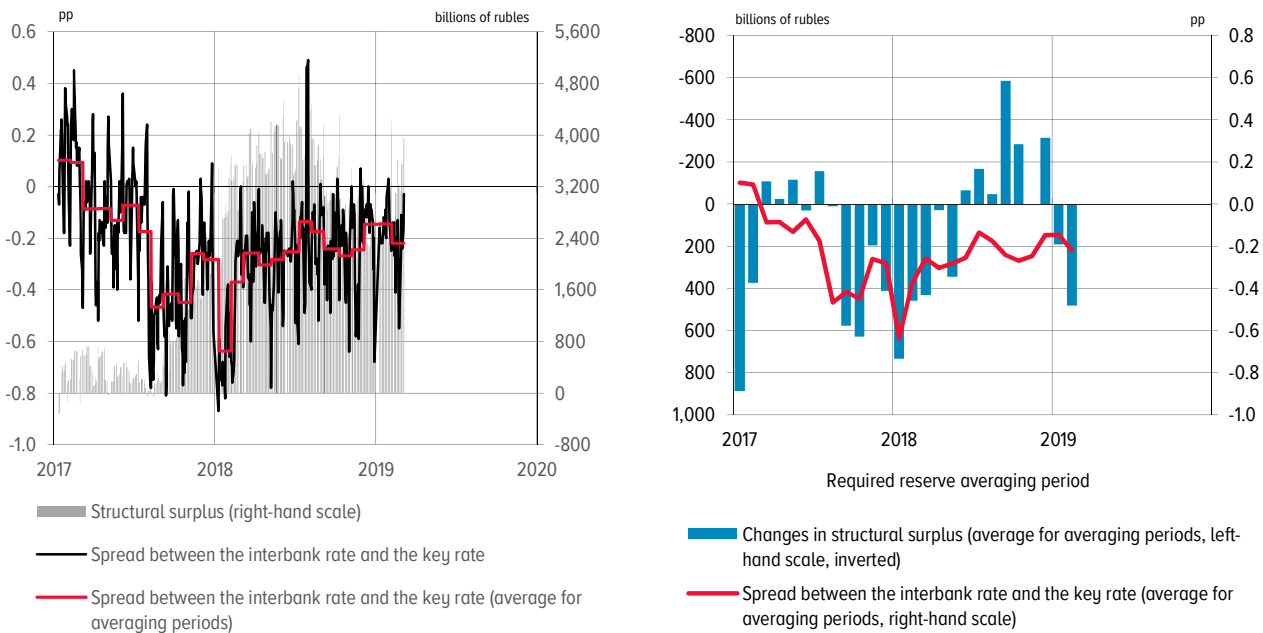
Chart 1



Source: Bank of Russia calculations.

INTERBANK LENDING RATES REMAINED IN THE LOWER RANGE OF THE BANK OF RUSSIA INTEREST RATE CORRIDOR

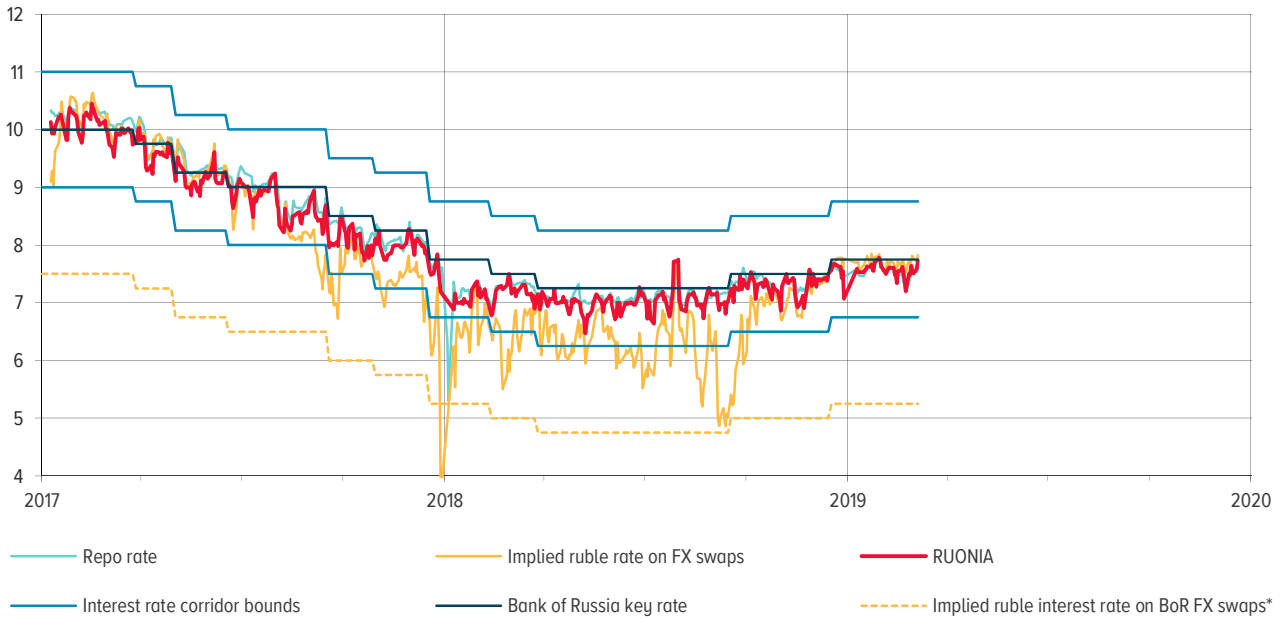
Chart 2



Source: Bank of Russia calculations.

INTEREST RATE SPREADS IN THE FX SWAP
AND INTERBANK SEGMENTS REMAINED POSITIVE (PP)

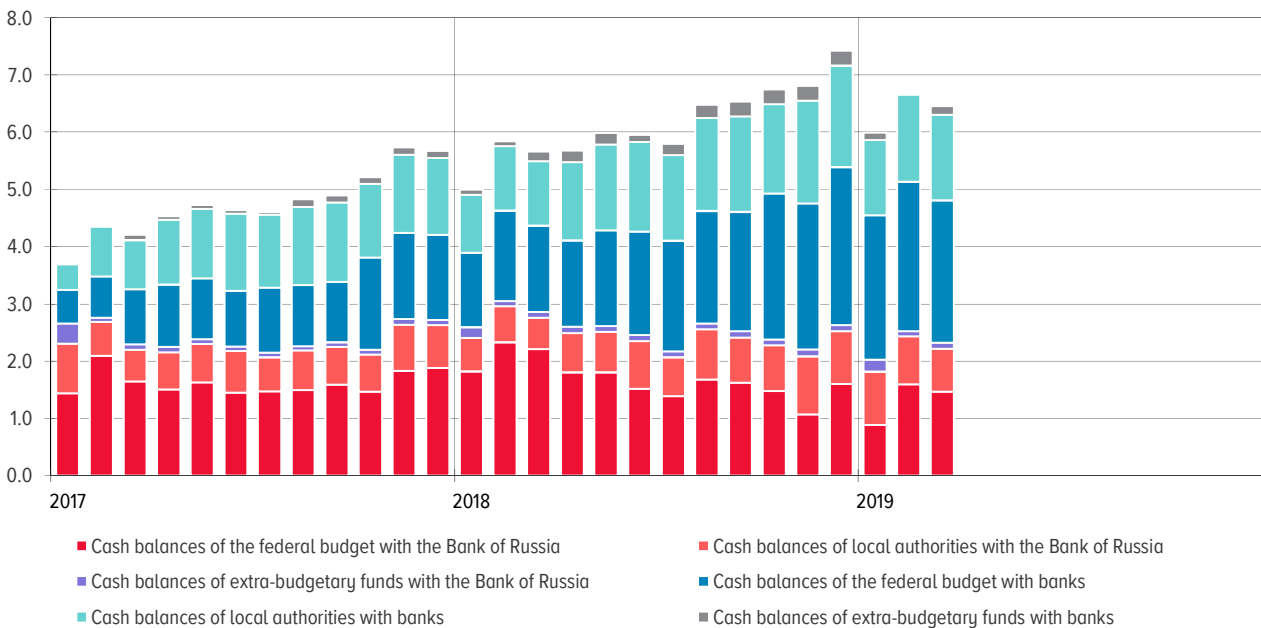
Chart 3



* Implied rate = ruble lending rate - FX borrowing rate + LIBOR
(from 19 December 2016: key rate - 1 pp - (LIBOR + 1.5 pp) + LIBOR = key rate - 2.5 pp)
Source: Bank of Russia calculations.

BALANCES OF TEMPORARILY AVAILABLE FUNDS PLACED WITH BANKS AND IN ACCOUNTS WITH THE BANK OF RUSSIA
DECREASED SOMEWHAT ON THE BACK OF A SEASONAL INCREASE IN BUDGET EXPENDITURES (TRILLIONS OF RUBLES)

Chart 4



Source: Bank of Russia calculations.

IN FEBRUARY 2019, THE BANKING SECTOR'S STRUCTURAL LIQUIDITY SURPLUS INCREASED
(START OF BUSINESS, TRILLIONS OF RUBLES)

Table 3

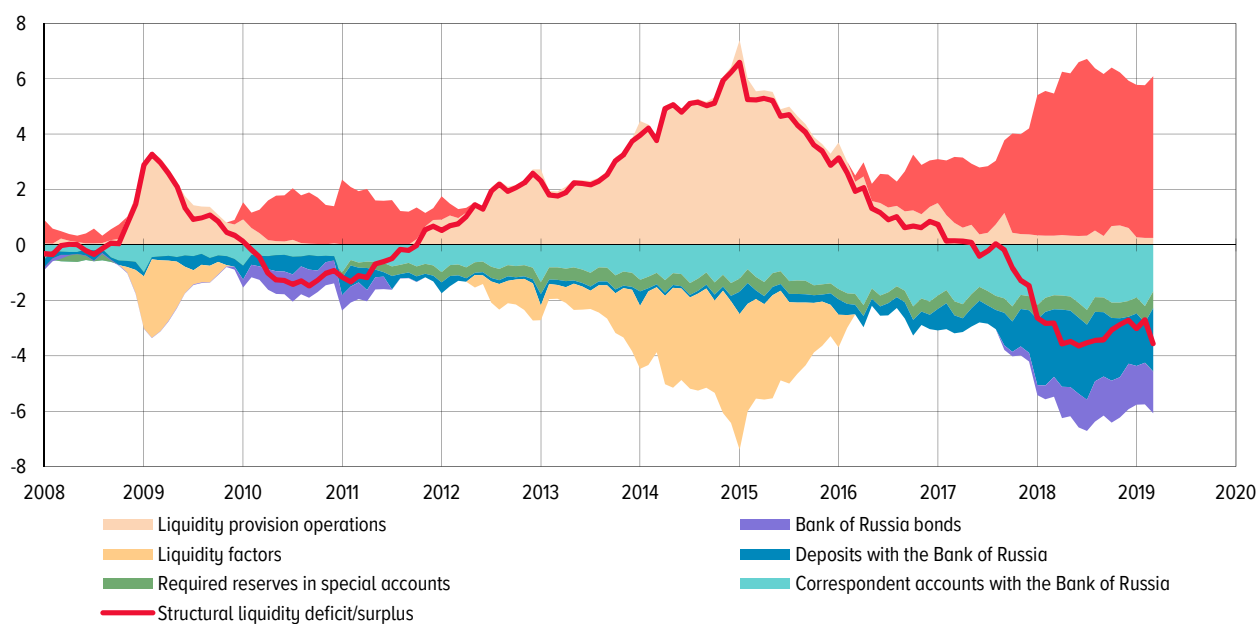
	1 January 2017	1 January 2018	1 January 2019	1 February 2019	1 March 2019
Structural liquidity deficit (+) / surplus (-)	0.7	-2.6	-3.0	-2.7	-3.6
Bank of Russia standard monetary policy instruments					
Bank of Russia claims on credit institutions	1.3	0.0	0.0	0.0	0.0
Auction-based facilities	0.2	-	-	-	-
– repos and FX swaps	-	-	-	-	-
– secured loans	0.2	-	-	-	-
Fixed interest rate facilities	1.0	0.0	0.0	0.0	0.0
– repos and FX swaps	0.6	0.0	0.0	0.0	0.0
– secured loans	0.4	0.0	0.0	0.0	0.0
Credit institutions' claims on the Bank of Russia	0.8	2.7	3.3	3.0	3.8
Deposits	0.8	2.4	1.9	1.4	2.3
– auction-based	0.4	2.1	1.5	1.3	2.1
– fixed interest rate	0.4	0.2	0.4	0.1	0.2
Bank of Russia bonds	0.0	0.4	1.4	1.5	1.5
Standing reverse facilities other than Bank of Russia standard monetary policy instruments*	0.3	0.1	0.3	0.2	0.2

* These transactions include Bank of Russia specialised refinancing instruments, Bank of Russia loans issued under irrevocable credit lines, and USD/RUB and EUR/RUB sell/buy FX swaps.

Source: Bank of Russia calculations.

BANK OF RUSSIA BALANCE SHEET (TRILLIONS OF RUBLES)

Chart 5



Source: Bank of Russia calculations.

FOREIGN EXCHANGE AND STOCK MARKET

The optimistic sentiment seen in the Russian financial market in January eased somewhat in February. The same is true for other emerging market economies (EMEs). The positive sentiment associated with the softening of the US Fed's rhetoric and the progress in the trade negotiations between China and the US rolled back in January, while no other significant developments have taken place. In Russia's case, the market was negatively affected by the news about possible tightening of sanctions against Russia; however, the reaction by market participants was more moderate compared with past similar episodes.

Foreign exchange rate. The RUB/USD exchange rate decreased in February by 0.3%, which is in line with overall developments in EMEs. The JP Morgan EM currency index fell by 0.7% in the same period. The negative effect of sanction tightening proved short-lived and the market overcame it as oil prices grew on the back of an additional oil production cut by Saudi Arabia.

Country risk premium. CDS spreads of most EMEs, including Russia, continued to go down in February. However, Russia's CDS spread showed a lower decline as of the month end than that in other EMEs (1.5 bp vs 7.3 bp). This is largely associated with the news about possible sanctions. The January issue of the commentary noted³ that according to the Bank

of Russia's estimates the decrease in CDS premiums seen from the beginning of the year looked somewhat excessive. A certain technical correction is possible late in March when 5-year CDS spread will be calculated for a new contract (which is done on a regular basis). Historical data suggest that this correction may reach up to 15 bp.

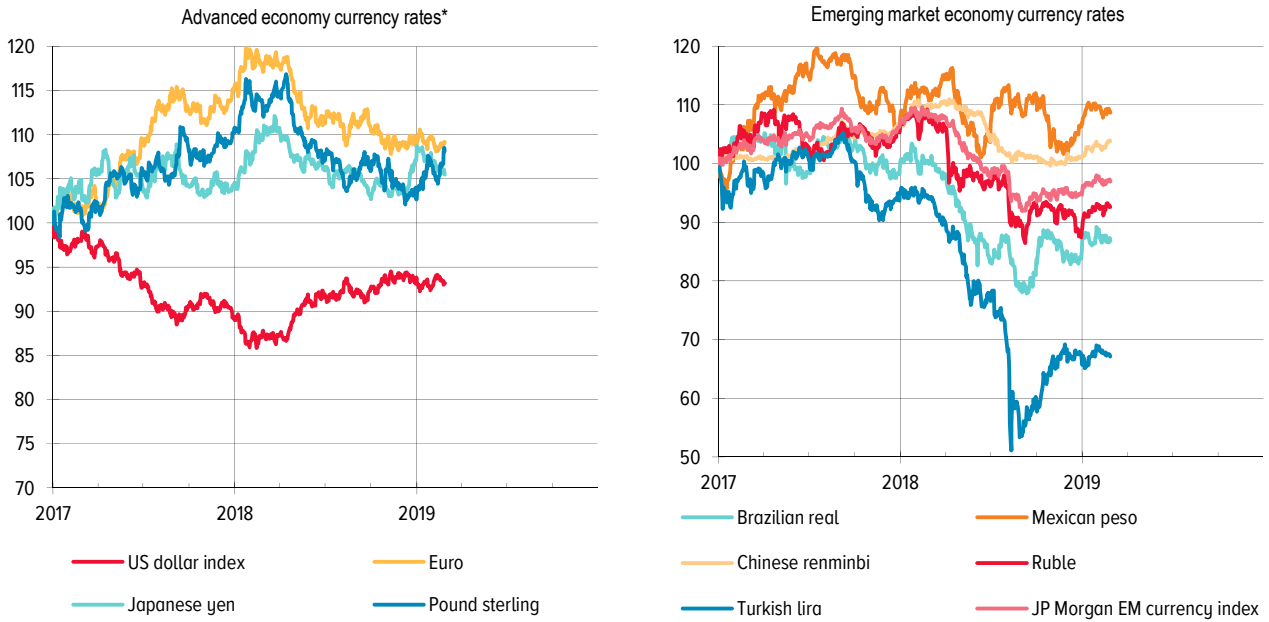
OFZ. The OFZ market saw yield growth of long issues in the past month, which can also be attributed to concerns about sanction tightening. At the same time, exchange data suggest that foreign investors were again OFZ net buyers in February; they bought securities worth 46 billion rubles. Of which, 28.5 billion rubles-worth securities were purchased at the latest Ministry of Finance auction. This was the largest volume since September 2017, when non-residents bought securities worth 29.7 billion rubles. That said, the range of participants was quite broad, suggesting that non-residents find the current OFZ yield attractive.

Stocks. In February, after a sizeable January expansion of the stock market, the ruble-denominated MOEX Index dropped by 1.2%, whereas the dollar-denominated MSCI Russia Index fell by 2.1%. Other EMEs, bar China, face similar developments. The MSCI China index added 3.5% in February (11.3% in January) on the back of successful trade negotiations with the US. As a result, the MSCI EM index reflecting the EME stock market dynamics added 0.1% as of the month end.

³ *Banking sector liquidity and financial markets, No. 1 (35), January 2019.*

THE RUBLE DEPRECIATED MODERATELY IN FEBRUARY SIMILAR TO OTHER EME CURRENCIES

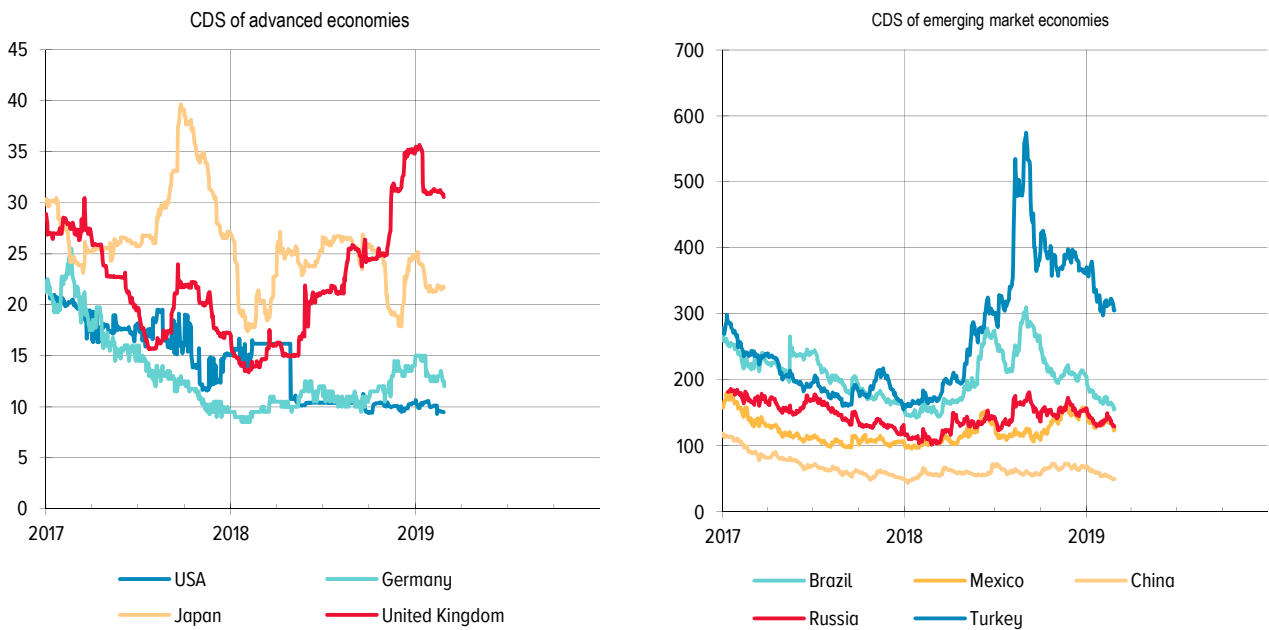
Chart 6



* Against the US dollar. Inverted exchange rate.
Sources: Bloomberg, Bank of Russia calculations.

THE DECLINE IN RUSSIA'S CDS SPREAD WAS LOWER THAN IN OTHER EMES DUE TO THE THREAT OF NEW SANCTIONS

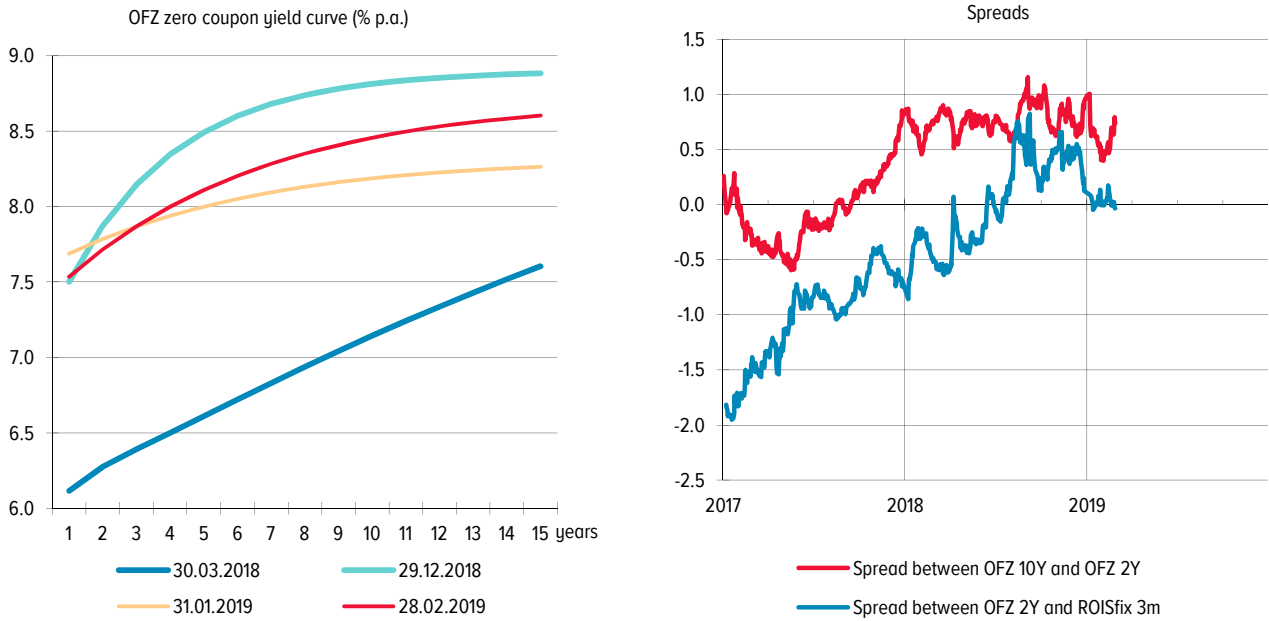
Chart 7



Sources: Bloomberg, Bank of Russia calculations.

THE LONG SECTION OF THE OFZ ZERO COUPON YIELD CURVE SHIFTED UPWARDS AMID THE CONCERNS OVER TIGHTER SANCTIONS

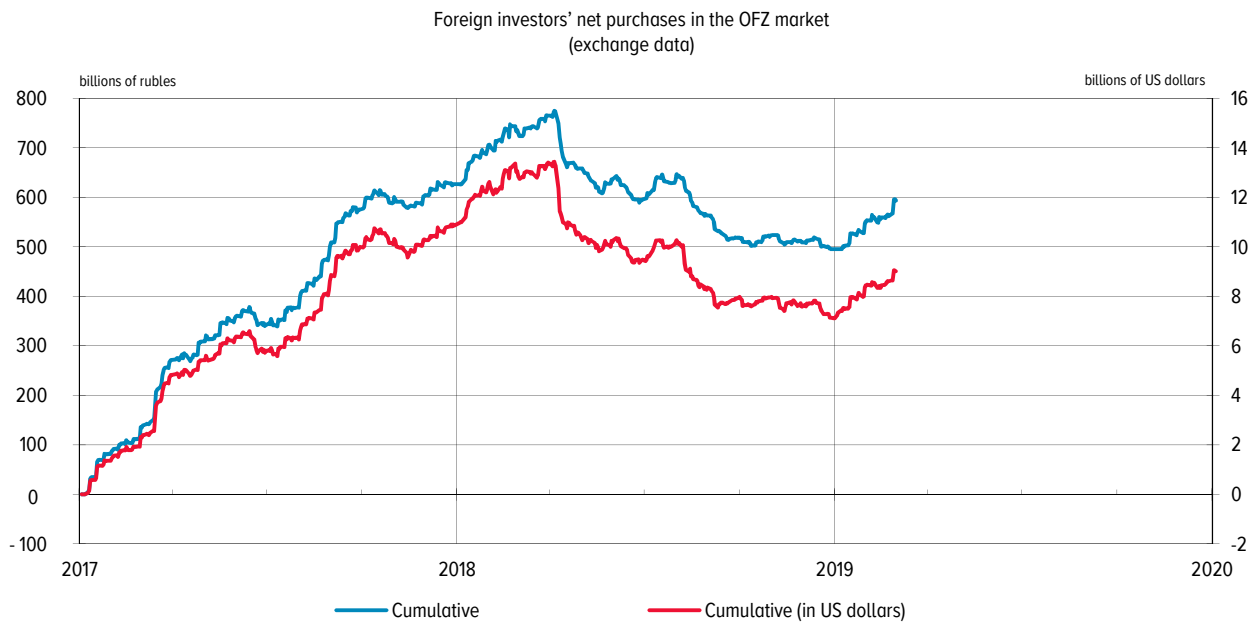
Chart 8



Source: PJSC Moscow Exchange.

IN FEBRUARY, FOREIGN INVESTORS CONTINUED TO INCREASE OFZ INVESTMENTS

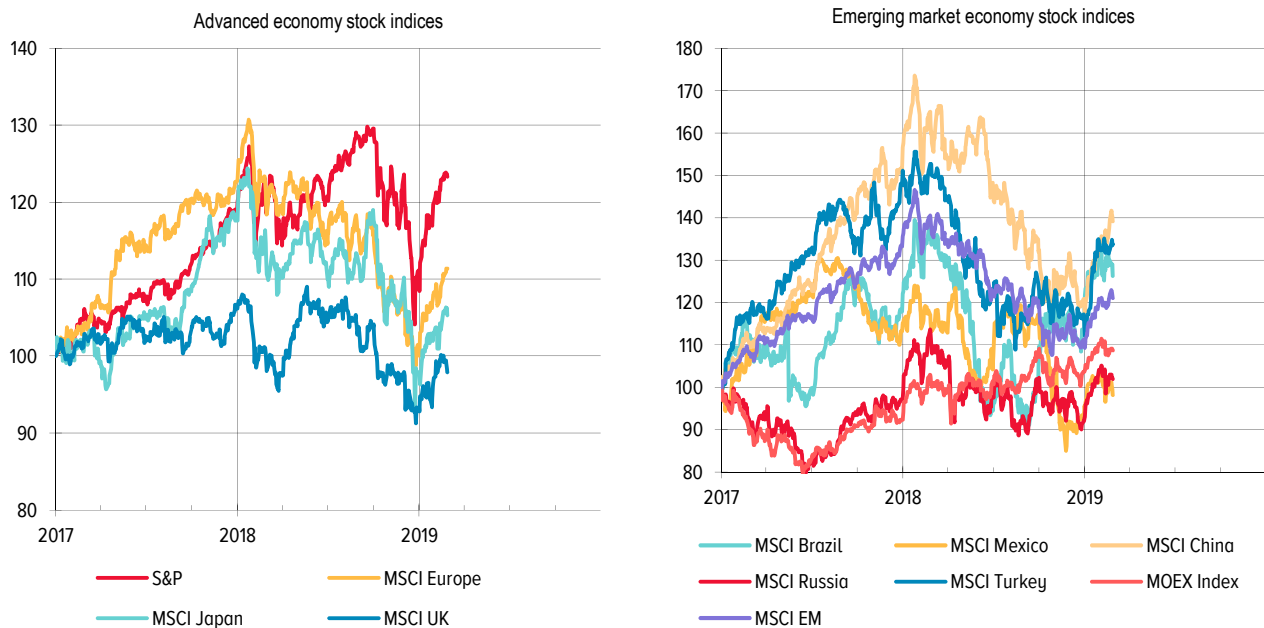
Chart 9



Source: Bank of Russia calculations.

STOCK INDICES OF MOST EMES, INCLUDING RUSSIA, DROPPED

Chart 10



Sources: Bloomberg, Bank of Russia calculations.

MOST SEGMENTS OF THE RUSSIAN MARKET SAW A PRICE DOWNTURN

Table 4

Stock market indicators					
Segment	Indicator	As of 28 February 2019 COB*	Change**		2018 average*
			monthly	monthly average	
Equity market	MICEX index	2,485.3	-1.4	1.7	2,314.4
	RTS index	1,188.3	-2.2	2.9	1,162.7
Bond market	OFZ	8.12	10.0	-7.8	7.7
	Corporate bonds	8.92	7.0	0.5	8.1
	Regional bonds	8.69	11.0	5.1	7.9
Foreign market	Russia-43	5.05	-6.3	-4.9	5.3
	UST-10	2.72	8.6	-4.2	2.9
Risk appetite indicators	RVI	23.1	1.3	-0.6	25
	EMBI+ Russia	198	-12.0	-1.6	202.5
	EMBI+ EM	384.4	-2.5	-16.7	380.2
	CDS	129.2	-1.5	-0.9	138.7

* Points for equity and RVI indices, % p.a. for bonds, basis points for other indicators.

** % for equity indices, points for RVI, basis points for other indicators.

Sources: Bloomberg, PJSC Moscow Exchange, Cbonds.ru, Bank of Russia calculations.

CREDIT AND DEPOSIT MARKET

Deposit rates. The trend towards the increase in deposit rates that emerged in September 2018 held in the first months of 2019 (Chart 11). In January, rates on both short-term and long-term household deposits exceeded the previous month readings. In February, banks continued to raise interest rates on standard deposit products and offer seasonal deposits at higher interest rates. In the second half of the month, banks were more active in the segment of seasonal deposits (mostly short-term and medium-term ones). This may suggest that banks do not expect further rate growth and are trying to prevent excessive accumulation of comparatively high-value long-term funding, while remaining competitive in the deposit market.

Deposit operations. The rate of funds inflow to household deposits in early 2019 remained moderate. The seasonal decline in ruble deposit balances in January resulted in a moderate decrease in annual deposit growth (Chart 12). The recovery of depositors' interest in long-term deposits that emerged in late 2018 continued into 2019. By the end of January, annual growth of ruble-denominated long-term deposits came in at 10.3% with long-term deposits accounting for 37.2% of the portfolio of ruble-denominated household deposits. Both indicators reached their highest readings since 2017. The inflow of household funds to FX deposits that emerged in November 2018, held in early 2019. However, its scale remained moderate and the share of FX deposits in the retail portfolio fluctuated near the current level in the past months.

Credit rates. The credit market also saw a rate increase in early 2019 (Chart 11). This was most clearly seen in the mortgage market where a number of large banks raised their rates bringing the market average rate on all long-term household loans up by almost 0.6 pp to 13.1% p.a. in January, according to preliminary data. In other market segments, the rate increase was less pronounced; however, it contributed to a moderate tightening of lending conditions for retail and corporate customers in the period under review (Chart 15).⁴

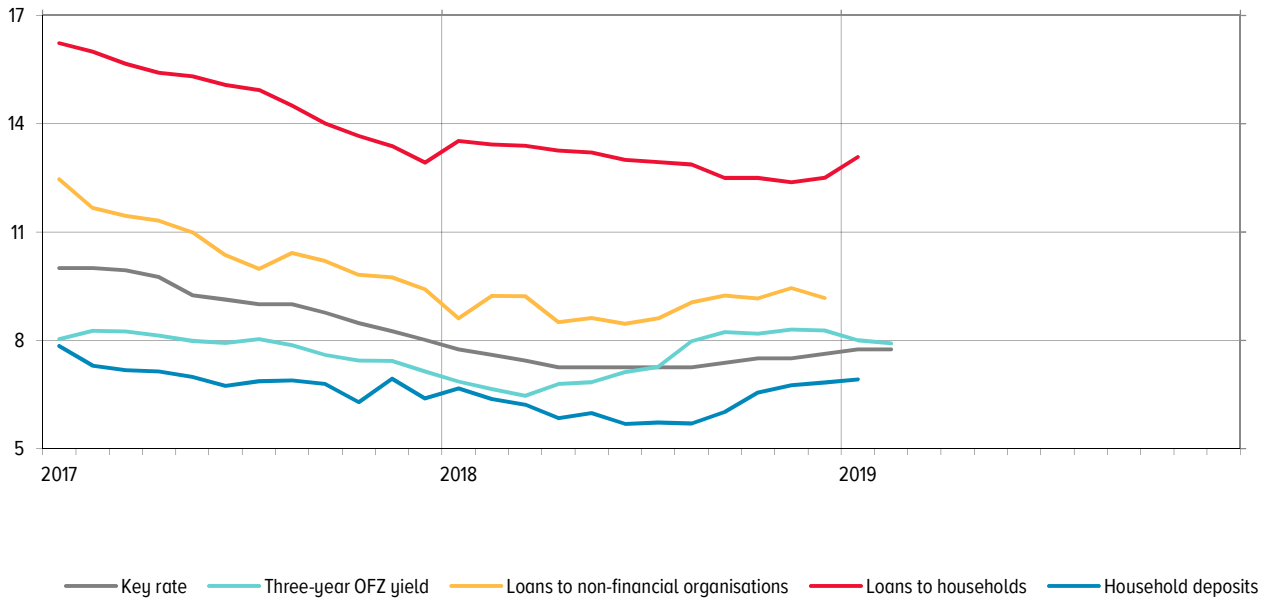
Corporate lending. The trend towards the replacement of FX loans with ruble-denominated ones, which prevailed in the corporate segment in 2018 held in early 2019. In January, the portfolio of ruble-denominated loans to non-financial organisations increased by 1.7% as the portfolio of FX loans shrank by 1.3% in dollar terms. As a result, overall growth in the corporate loans portfolio remained virtually unchanged (Chart 13). The growth in overdue corporate loans registered in January was mainly attributed to banks under financial resolution, and was largely associated with changes in accounting approaches as Russian accounting standards were brought in line with IFRS 9.

Retail lending. In the first months of 2019, the retail loan portfolios of Russian banks continued to grow at a high pace. Mortgages and consumer lending made comparable contributions to growth in the retail loan portfolio; that said, the trend towards a slow expansion of consumer lending in the retail loan portfolio held.

⁴ In accordance with the 2018 Q4 bank lending survey results.

INTEREST RATES CONTINUED TO GROW IN MOST SEGMENTS OF CREDIT AND DEPOSIT MARKETS

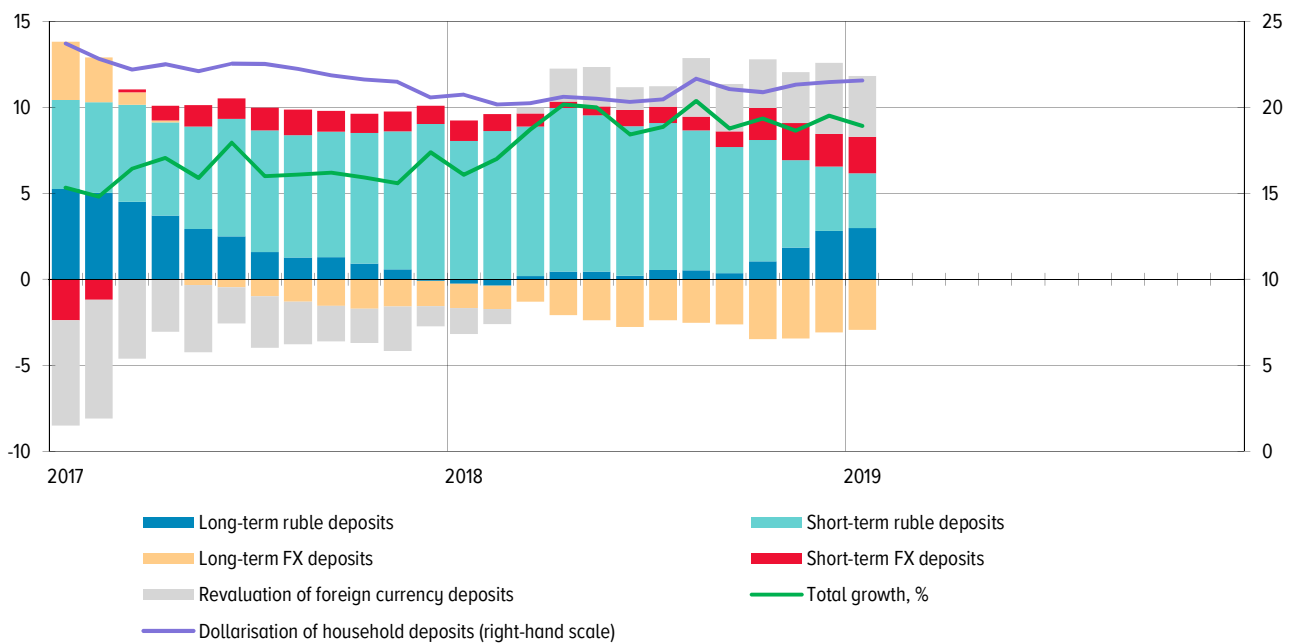
Chart 11



Source: Bank of Russia.

DEPOSITORS' INTEREST IN LONG-TERM RUBLE DEPOSITS CONTINUES TO RECOVER

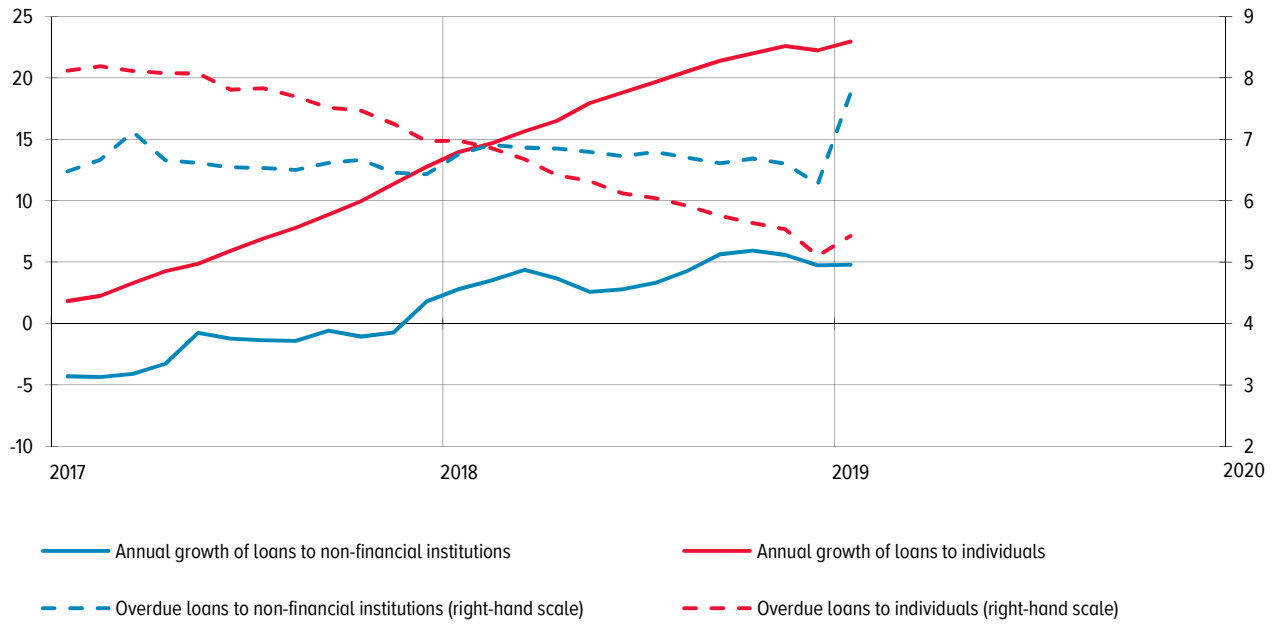
Chart 12



Source: Bank of Russia calculations.

HOUSEHOLD LENDING GREW AT AN OUTPACING RATE

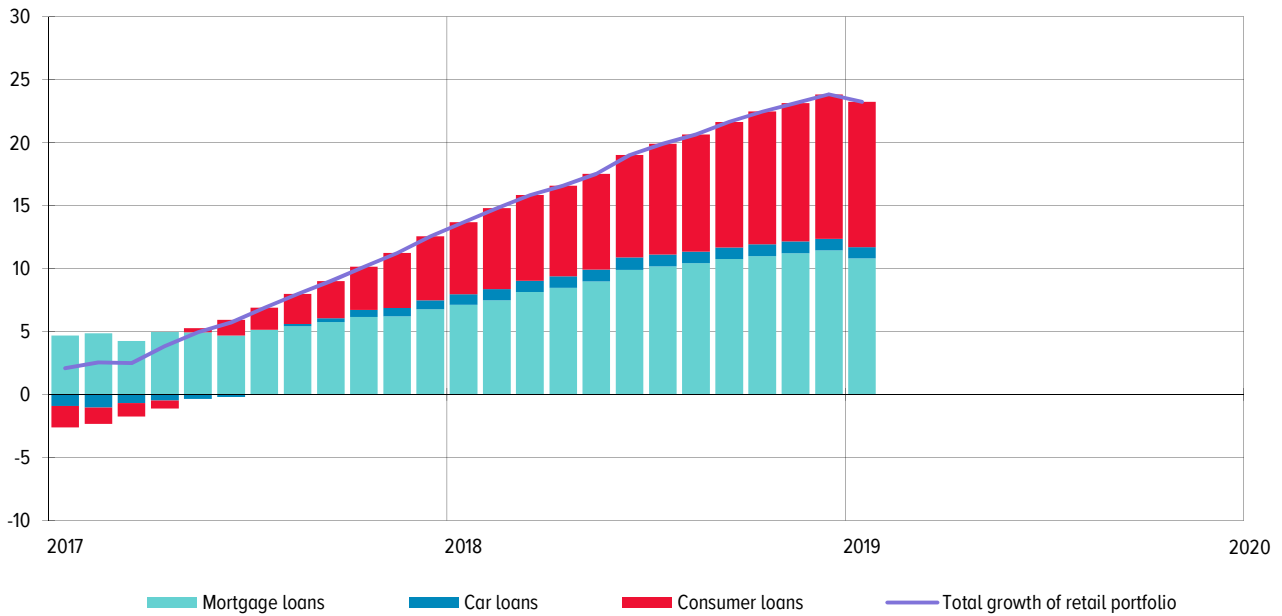
Chart 13



Source: Bank of Russia calculations.

IN EARLY 2019, THE CONTRIBUTION OF MORTGAGE AND CONSUMER LENDING TO RETAIL LENDING WAS COMPARABLE

Chart 14



Source: Bank of Russia calculations.

PARTICIPANT BANKS OF THE BANK LENDING SURVEY LARGELY ATTRIBUTE THE MODERATE TIGHTENING OF LENDING CONDITIONS IN LATE 2018 AND EARLY 2019 TO THE UPWARD REVISION OF CREDIT RATES

Chart 15



Source: Bank of Russia.

CREDIT AND DEPOSIT MARKET INDICATORS

Table 5

Stock market indicators					
		January 2018	November 2018	December 2018	January 2019
Rates on long-term ruble-denominated bank operations*					
– household deposits	% p.a.	5.7	6.0	5.6	-
– household loans	% p.a.	13.5	12.4	12.5	-
– corporate loans	% p.a.	8.6	9.4	9.2	-
Household deposits					
– in rubles	% YoY, AFCR**	7.6	5.7	5.4	5.4
– in foreign currency	% YoY	10.2	8.9	8.3	7.8
– dollarisation	%	-0.8	-5.6	-5.2	-3.6
– dollarisation	%	20.7	21.3	21.5	21.5
Loans to non-financial organisations					
– short-term (less than 1 year)	% YoY, AFCR	2.8	5.6	4.7	4.8
– long-term (more than 1 year)	% YoY, AFCR	-7.4	3.7	3.8	-0.6
– overdue loans	%	4.9	6.0	5.4	4.9
Loans to households					
– housing mortgage loans	%	6.8	6.6	6.3	7.8
– unsecured consumer loans	% YoY, AFCR	14.0	22.6	22.2	22.8
– overdue loans	% YoY	16.8	25.5	23.4	23.7
	%	12.3	22.5	22.7	23.2
	%	7.0	5.5	5.1	5.4

* YoY - on corresponding period of previous year.

** AFCR - adjusted for foreign currency revaluation.

Source: Bank of Russia calculations.

Cut-off dates:

- 'Banking sector liquidity and money market' section – 5 March 2019 (reserve requirements are an important part of the Bank of Russia's instruments to manage banking sector liquidity and money market rates. Therefore, the analysis of the effectiveness of the Bank of Russia's monetary policy operational procedure should take into account required reserves averaging periods. In February-March 2019, this period is from 6 February 2019 to 5 March 2019);
- 'Foreign exchange and stock market' section – 28 February 2019;
- 'Credit and deposit market' section – 1 February 2019.

A soft copy of information and analytical commentary is available on the Bank of Russia website (<http://www.cbr.ru/DKP/>). Please send your comments and suggestions to svc_analysis@cbr.ru.

This commentary is prepared by the Monetary Policy Department.

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