Bank of Russia

BANKING SECTOR LIQUIDITY AND FINANCIAL MARKETS

No. 6 (52) • June 2020

Information and analytical commentary

10 July 2020

BANKING SECTOR LIQUIDITY AND FINANCIAL MARKETS: FACTS, ASSESSMENTS AND COMMENTS (JUNE 2020)

- In June, the structural liquidity surplus shrank to 1.2 trillion rubles (-0.4 trillion rubles). One of the reasons behind this was that banks were delaying their required reserves averaging, expecting the Bank of Russia to cut the key rate at the June meeting of the Board of Directors. Overall, the improving trends of liquidity factors supported the inflow of funds to banks.
- The spread between interbank lending rates and the Bank of Russia key rate expanded to -32 bp (vs -14 bp in the May averaging period) as market participants expected a key rate decrease by the Bank of Russia's Board of Directors at its June meeting.
- The interest rate spread in the FX swap and interbank lending segments turned negative, reaching -12 bp (vs +3 bp in the May averaging period). The cost of foreign currency liquidity went up, pushed by a decrease in foreign currency supply by individual banks.
- In early June, financial markets in most countries continued the upward trend amid a progressive economic recovery. However, the second ten days of the month induced pessimism in markets due to concerns about a potential resurgence of the coronavirus in the USA and a growing number of active cases in emerging market economies.
- Market participants' expectations regarding the key rate continued to lower in June. Therefore, the key rate reduction by 100 bp was foreseeable by the majority of market participants and caused no volatility in the market.
- May recorded an inflow of funds into short-term ruble-denominated household deposits and a simultaneous reduction in long-term deposit balances, explaining individuals' need to cover their current expenses in the conditions of the lockdown. Retail clients' interest in foreign currency deposits generally remained low.
- In May, the average market interest rate on mortgage loans hit its new record low, dropping to 7.4%. A considerable decrease in the mortgage rate was driven by both the easing of monetary policy and the implementation of the preferential mortgage lending programmes.
- Activity in the retail lending market trended down in May mostly because of consumer lending. The growth of the corporate loan portfolio remained steady.

Banking sector liquidity and money market

Ruble liquidity. Over June, the structural liquidity surplus contracted by 0.4 trillion rubles, to total 1.2 trillion rubles (Table 2). Moreover, its amount averaged 1.7 trillion rubles in the June required reserves averaging period (vs 1.6 trillion rubles in the May averaging period).

One of the reasons why the liquidity surplus shrank as of early July was that banks expected the Bank of Russia to cut the key rate at the Board of Directors' meeting in June. Consequently, credit institutions were delaying their required reserves averaging for the second half of the averaging period. As a result, by early July they increased balances in their correspondent accounts with the Bank of Russia, simultaneously reducing the amount of deposits year-over-year.

Budget revenues from the payment of the main taxes continued to decrease in June. Specifically, the payments of the profit tax, which is generally procyclical, plummeted over the month. Concurrently, budget spending significantly rose, primarily due to operations on extra-budgetary funds' accounts, that is, payments to households, including to families with children, and healthcare costs. Expenditures of general government exceeded its revenues, and this gap was covered primarily through a decrease in balances in the federal budget accounts with the Bank of Russia, as well as through the offering of federal government bonds (OFZs), and a reduction in budgetary funds placed in bank deposits by constituent territories of the Russian Federation. Banks' debt on Federal Treasury (FT) operations, including the placements of the resources of the Social Insurance Fund (SIF), expanded by 0.3 trillion rubles. The aggregate inflow of funds within these budget operations was partially offset by the continuing increase in the amount of cash in circulation and fiscal rule-based operations to sell foreign currency.

As the trends of liquidity factors were gradually normalising and credit institutions managed to better adjust to the reduced structural surplus, banks showed low demand at the Bank of Russia's repo auctions held on 22 June 2020. As a result, the one-month auction was declared void due to the absence of bids, while demand at the one-year auction totalled 5.1 billion rubles.

In June, the Bank of Russia continued to reduce its coupon bond (coupon OBR) offerings so as to ensure greater flexibility in absorbing liquidity through its weekly deposit auctions. Thus, only the 32nd coupon OBR issue was placed in June. Consequently, the amount of outstanding coupon OBRs shrank by 0.4 trillion rubles, to total 0.7 trillion rubles.

Money market. The spread between short-term interbank lending rates[1] and the Bank of Russia key rate expanded to -32 bp (vs -14 bp in the May averaging period) (Chart 2). The spread volatility rose to 26 bp (vs 8 bp in the May averaging period). The expansion of the spread and its higher volatility were associated with market participants' expectations of a key rate reduction at the Bank of Russia Board of Directors' meeting on 19 June. In the first half of the averaging period, the spread was hovering around -55 bp on average since banks were seeking to place their funds at the Bank of Russia's deposit auctions or in the money market, expecting a key rate cut and, therefore, partially delaying their required reserves averaging for the second half of the averaging period. Consequently, the supply of liquidity at deposit auctions notably exceeded the established limits (Chart 4). After the Board of Directors' meeting, the excess supply at deposit auctions shrank, and interbank lending rates came closer to the Bank of Russia key rate.

Foreign currency liquidity. The interest rate spread in the FX swap and interbank lending (basis) segments turned negative, expanding to -12 bp on average (vs +3 bp in the May averaging period) (Chart 3). The cost of foreign currency liquidity went up, driven by a slight reduction in foreign currency supply in the FX swap segment by individual banks as their net foreign currency liabilities to companies decreased. Furthermore, in June non-residents generally reduced their short ruble positions in the FX swap segment compared to May, which could also push the cost of foreign currency liquidity upwards.

The forecast of the structural liquidity surplus for the end of 2020 remains at the level of 2.2–2.8 trillion rubles.

Key rate expectations. Market participants' expectations regarding the key rate continued to lower in June. Therefore, the key rate reduction by 100 bp was foreseeable by the majority of market participants and caused no volatility in the foreign exchange and bond markets. According to information available, market participants expect the key rate to be cut further by another 50 bp by the end of the year (Table 1).

[1] *The interbank lending rate is the interest rate charged on unsecured loans in the money market.*

THE KEY RATE EXPECTED BY THE END OF YEAR LOWERED TO 4% *Table 1*

1. Expectations based on market indicators,* interest rate (instrument)	June 2020	December 2020
– MosPrime 3M (FRA)	4.43 (4.67)	4.43 (4.59)
– RUONIA (ROISfix)	4.11 (4.45)	4.04 (4.47)
– RUONIA (futures)	4.37 (4.54)	4.31 (4.58)
2. Analysts' key rate expectations*	**As of 30.06.2020**	**As of 31.12.2020**
– Bloomberg survey	4.00 (4.75)	4.00 (4.50)
– Reuters survey	4.00 (4.50)	4.00 (4.50)

** Values are given as of the end of the current and previous (in brackets) months.*
Source: Bank of Russia calculations.

IN JUNE 2020, THE BANKING SECTOR'S STRUCTURAL LIQUIDITY SURPLUS DECREASED *Table 2*
(START OF BUSINESS, BILLIONS OF RUBLES)

	01.01.2017	01.01.2018	01.01.2019	01.01.2020	01.06.2020	01.07.2020
Structural liquidity deficit (+) / surplus (-)	**736**	**-2,639**	**-3,016**	**-2,761**	**-1,581**	**-1,151**
Bank of Russia's claims on credit institutions	**1,258**	**10**	**21**	**18**	**5**	**10**
Auction-based facilities	216	-	-	-	0	5
– repos and FX swaps	-	-	-	-	0	5
– secured loans	216	-	-	-	0	0
Fixed interest rate facilities	1,042	10	21	18	5	5
– repos and FX swaps	632	4	8	13	0	0
– secured loans	411	5	13	5	5	5
Credit institutions' claims on the Bank of Russia	**785**	**2,729**	**3,293**	**2,983**	**2,006**	**1,633**
Deposits	785	2,372	1,902	1,026	896	925
– auction-based	397	2,125	1,478	697	770	773
– fixed interest rate	388	247	424	330	126	151
BoR coupon bonds	0	357	1,391	1,956	1,110	708
Standing reverse facilities, other than standard monetary policy instruments of the Bank of Russia*	**263**	**81**	**256**	**204**	**420**	**472**

** These transactions include the Bank of Russia's specialised refinancing instruments, loans granted by the Bank of Russia within irrevocable credit lines, and USD/RUB and EUR/RUB sell/buy FX swaps.*
Source: Bank of Russia calculations.

THE FORECAST OF THE STRUCTURAL LIQUIDITY SURPLUS FOR THE END OF 2020 REMAINS AT THE LEVEL OF 2.2–2.8 TRILLION RUBLES *Table 3*

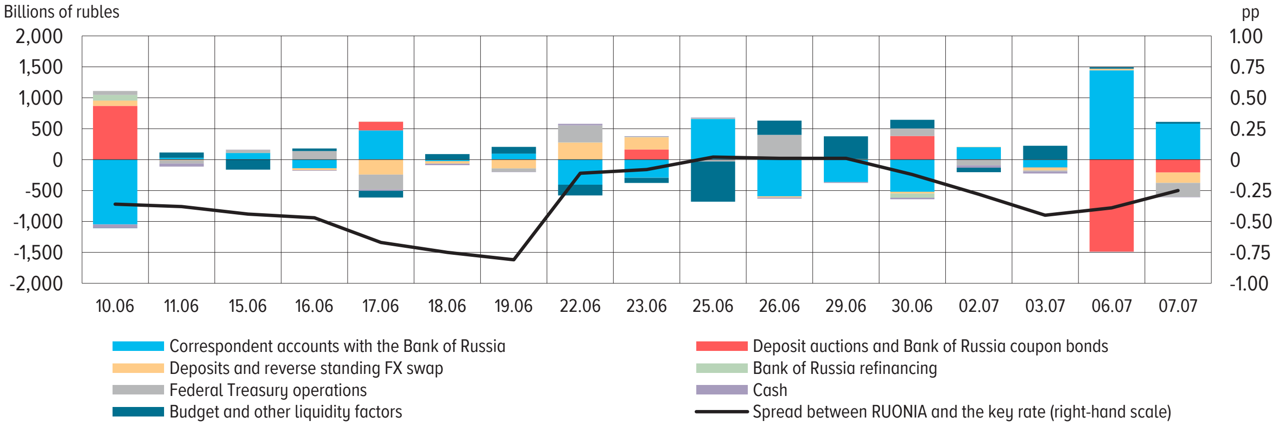
(TRILLIONS OF RUBLES)

	2019 (actual)	January–June 2020	June 2020	2020 (forecast)
1. Liquidity factors (supply)	**0.5**	**-0.7**	**0.4**	**[-0.5; 0.0]**
– change in the balances of funds in general government accounts with the Bank of Russia, and other operations*	0.2	1.0	0.7	[0.0; 0.3]
– change in the amount of cash in circulation	-0.1	-1.7	-0.4	[-0.6; -0.4]
– Bank of Russia interventions in the domestic FX market and monetary gold purchases**	0.4	0.1	0.0	0.1
– regulation of banks' required reserves with the Bank of Russia	0.0	0.0	0.0	-0.1
2. Change in free bank reserves (correspondent accounts)* (demand)**	**0.7**	**0.9**	**0.8**	**[-0.1; 0.0]**
3. Change in banks' claims on deposits with the Bank of Russia and BoR coupon bonds	**-0.3**	**-1.3**	**-0.4**	**[-0.6; 0.0]**
4. Change in outstanding amounts on Bank of Russia refinancing operations (4 = 2 + 3 - 1)	**-0.1**	**0.3**	**0.1**	**0.0**
Structural liquidity deficit (+) / surplus (-) (as of the period-end)	**-2.8**	**-1.2**		**[-2.8; -2.2]**

** Including fiscal rule-based operations to buy (sell) foreign currency in the domestic FX market, settlements on Bank of Russia USD/RUB FX swaps, and other operations.*
*** Forecast values of the indicator are in line with the actual amount of operations conducted.*
**** The forecast for the end of the year implies uniform averaging of required reserves by banks and correspondent account balances close to the required ratio.*
Source: Bank of Russia calculations.

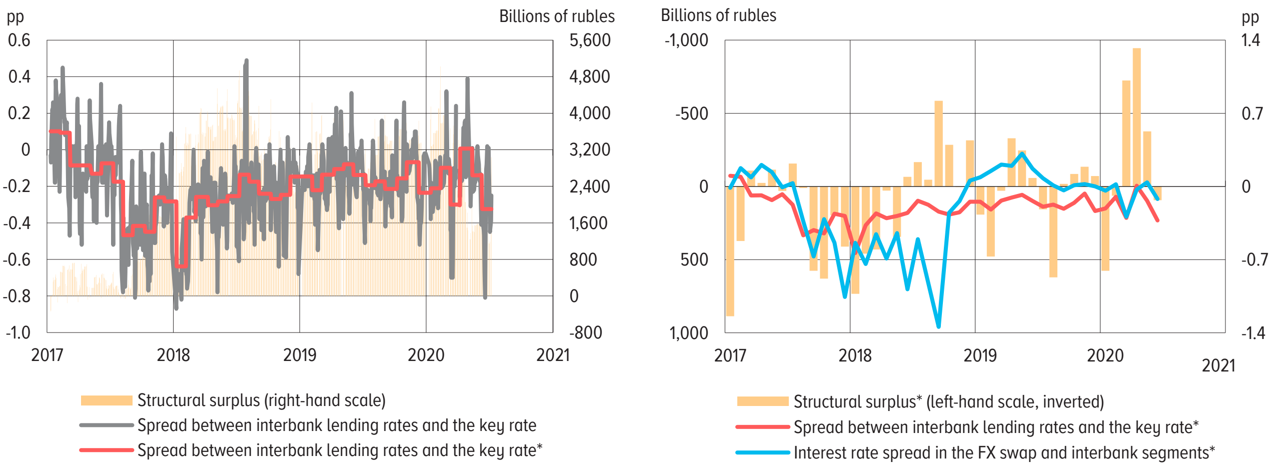
IN JUNE 2020, THE NORMALISING TRENDS OF LIQUIDITY FACTORS SUPPORTED THE INFLOW OF FUNDS TO BANKS *Chart 1*

CHANGES IN THE BANK OF RUSSIA'S BALANCE SHEET AND MONEY MARKET RATES (OVERNIGHT)



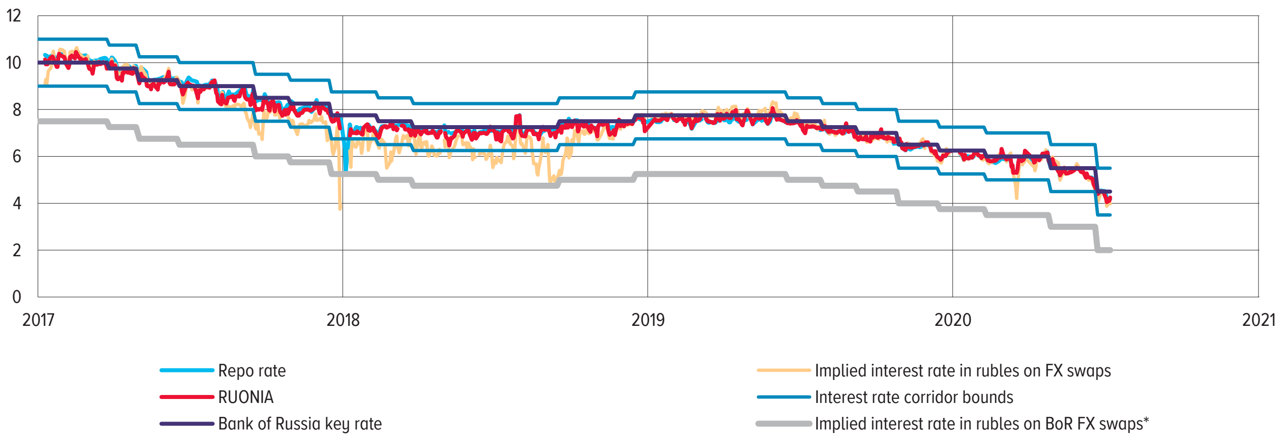
Source: Bank of Russia calculations.

THE SPREAD BETWEEN INTERBANK LENDING RATES AND THE BANK OF RUSSIA KEY RATE EXPANDED *Chart 2*



** Average for averaging periods.*
Source: Bank of Russia calculations.

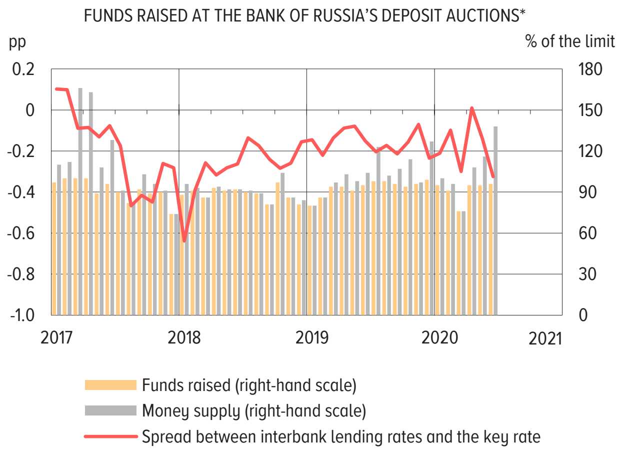
THE INTEREST RATE SPREAD IN THE FX SWAP AND INTERBANK LENDING SEGMENTS WIDENED, TURNING NEGATIVE *Chart 3*
(% P.A.)

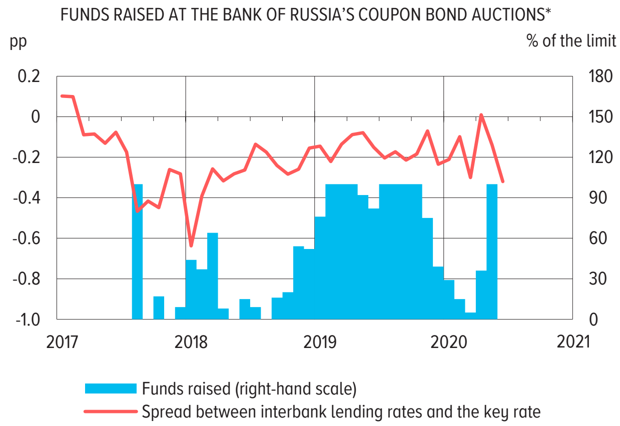


** Implied rate on BoR reverse FX swap = ruble lending rate – foreign currency borrowing rate + LIBOR (from 19.12.2016: key rate – 1 pp - (LIBOR + 1.5 pp) + LIBOR = key rate – 2.5 pp).*
Source: Bank of Russia calculations.

BANKS' SUPPLY AT THE BANK OF RUSSIA'S WEEKLY DEPOSIT AUCTIONS SUBSTANTIALLY EXCEEDED THE ESTABLISHED LIMITS IN THE FIRST HALF OF THE AVERAGING PERIOD

Chart 4

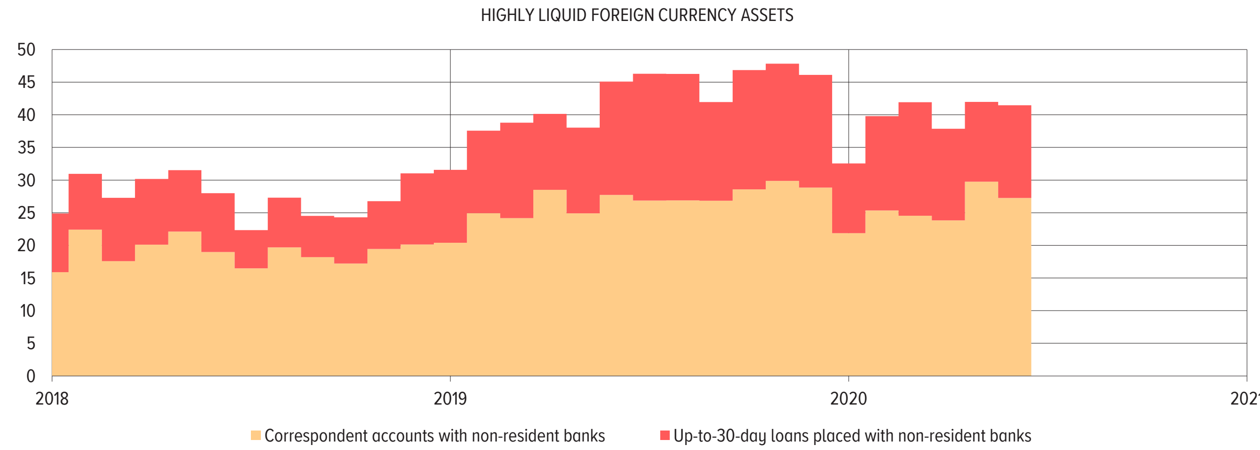




** Average for averaging periods.*
Source: Bank of Russia calculations.

THE AMOUNT OF HIGHLY LIQUID FOREIGN CURRENCY ASSETS CHANGED ONLY SLIGHTLY IN MAY (ACCORDING TO DATA AS OF 1 JUNE)
(BILLIONS OF US DOLLARS)

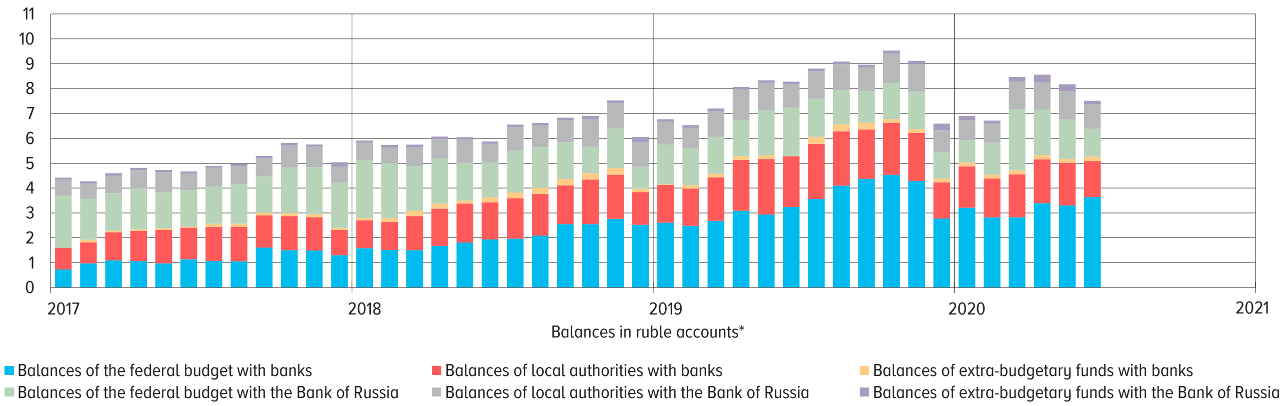
Chart 5



Source: Bank of Russia calculations.

IN JUNE, EXPENDITURES OF GENERAL GOVERNMENT EXCEEDED ITS REVENUES, AND THIS GAP WAS COVERED PRIMARILY THROUGH A DECREASE IN BALANCES IN THE FEDERAL BUDGET ACCOUNTS WITH THE BANK OF RUSSIA, AS WELL AS THROUGH OFZ PLACEMENTS, AND A REDUCTION IN BUDGETARY FUNDS PLACED IN BANK DEPOSITS BY CONSTITUENT TERRITORIES OF THE RUSSIAN FEDERATION
(TRILLIONS OF RUBLES, AS OF THE PERIOD-END)

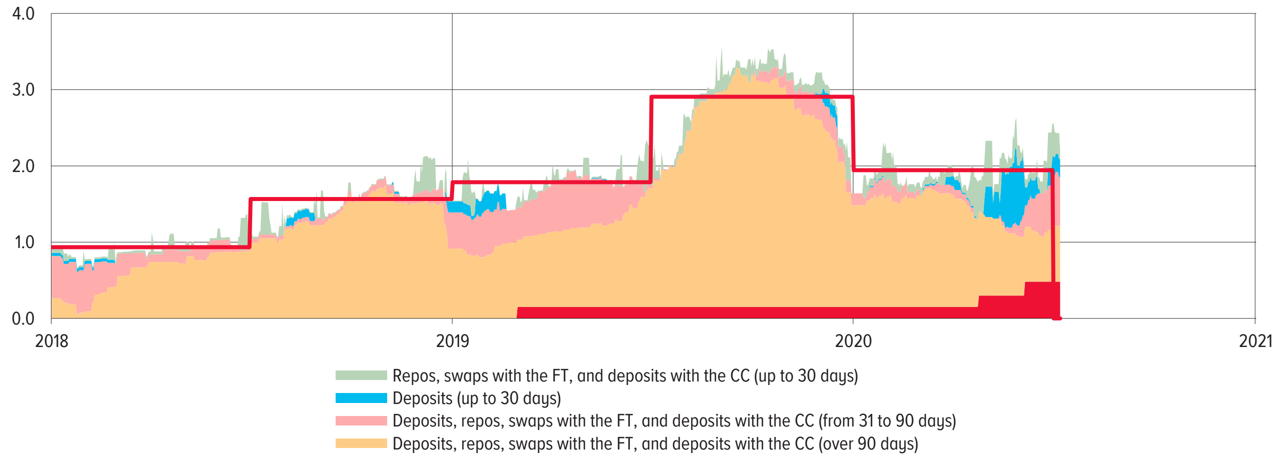
Chart 6



**According to banking reporting form 0409301 'Performance indicators of a credit institution'.*
Source: Bank of Russia calculations.

IN JUNE 2020, BANKS' DEBT ON FT OPERATIONS, INCLUDING THE PLACEMENTS OF THE SIF'S RESOURCES, EXPANDED BY 0.3 TRILLION RUBLES *Chart 7*

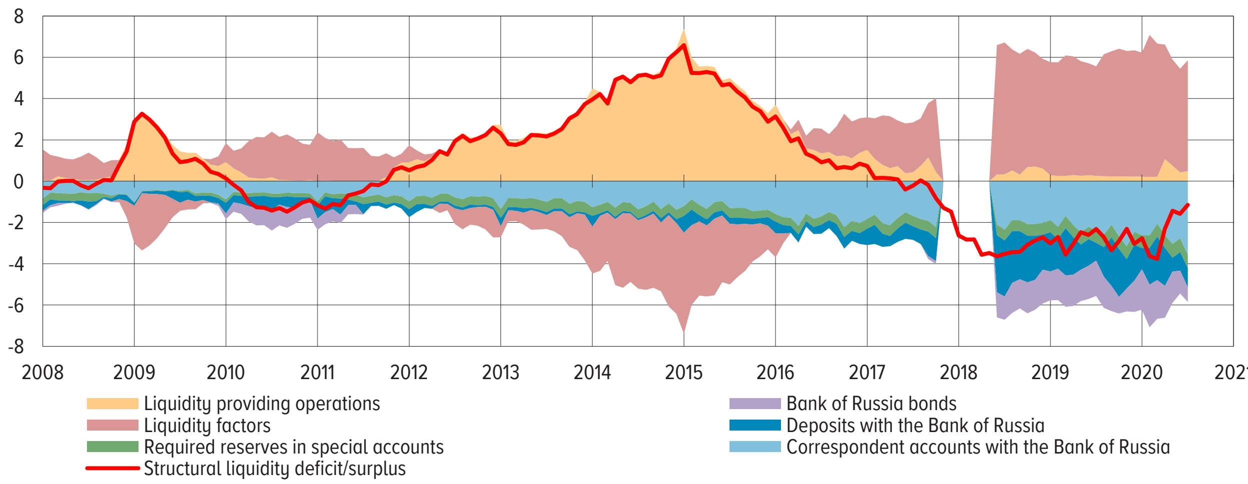
(TRILLIONS OF RUBLES)



Sources: Federal Treasury, Bank of Russia calculations.

BANK OF RUSSIA'S BALANCE SHEET *Chart 8*

(TRILLIONS OF RUBLES)



Source: Bank of Russia calculations.

Foreign exchange and stock markets

In early June, financial markets in most countries continued the upward trend amid a progressive economic recovery. However, the second ten days of the month induced pessimism in markets due to concerns about a potential resurgence of the coronavirus in the USA and a growing number of active cases in emerging market economies (hereinafter, EMEs).

Exchange rate. Having strengthened at the beginning of the month, the ruble then stayed relatively stable for a fortnight, after which it considerably depreciated in the last week of the month (3.4%). As a result, as of the end of the month, the exchange rate of the ruble declined by 1.5%, to 71.19 rubles per US dollar (Chart 9). The weakening of the ruble was partially associated with the general depreciation of EMEs' currencies (-0.9%) provoked by concerns about a potential resurgence of the coronavirus and increased geopolitical risks.

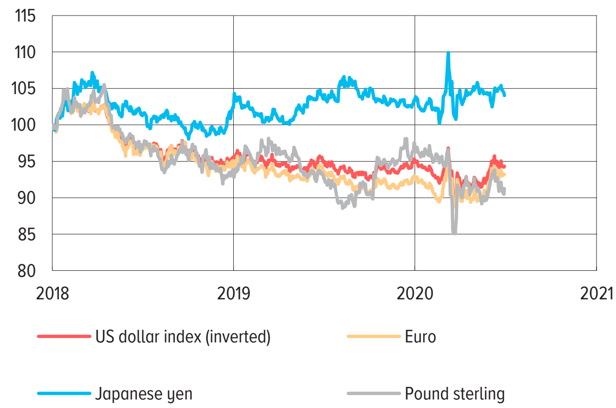
Country risk premium. Russia's CDS spread shrank from 117 bp to 110 bp. At its lowest (5 June 2020), the spread decreased to 80 bp, but then adjusted upwards because of the 'risk-off attitude' (Chart 10). Similar trends were also recorded in other EMEs, yet the adjustment of Russia's spread was higher due to geopolitical risks. By the end of the month, Turkey's CDS declined by 63 bp, South Africa's CDS – by 41 bp, and Brazil's CDS – by 27 bp.

Federal government bonds. The yield curve of OFZs with up to two-year maturities declined, while the yield curve of OFZs with longer maturities went up: 2Y – 4.57% (-8 bp); 10Y – 6.05% (+35 bp). As a result, the slope of the curve reached its early 2014 high (Chart 11). Russia's Ministry of Finance continued extensive OFZ offerings, but demand for them trended down in the second half of the month. As of the end of 2020 Q2, the amount of OFZ placements totalled 1.1 trillion rubles at par value. Another 1 trillion rubles is the target of the Ministry of Finance for 2020 Q3. Foreign investors increased their OFZ holdings by 19 billion rubles. Moreover, their transactions contrasted with sentiment in global markets. In the first half of June when positive sentiment still prevailed, non-residents were reducing their investments in OFZs (-35 billion rubles), while then they started to build up their OFZ holdings. From 10 through 23 June, non-residents increased their investments in OFZs by 61 billion rubles. At the end of the month, the market recorded net sales amid rising geopolitical concerns.

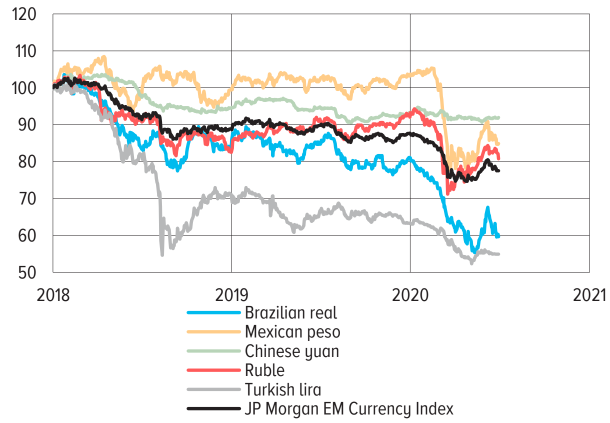
Stocks. Stock markets in EMEs were more positive than in advanced economies (Chart 12). As of the end of the month, MSCI EM gained 7.0%, while S&P rose by 1.8%, MSCI Europe added 3.0%, and MCSI Japan lost 0.01%. This difference is apparently explained by the fact that the risks of a resurgence of the coronavirus are currently higher in advanced economies since they were the first to lift their restrictions. Furthermore, in the second half of June, for the first time since the crisis outbreak, the US Fed's balance sheet began to contract, which tends to affect market sentiment negatively. The Russian stock indices remained almost unchanged due to increased geopolitical risks and the start of the dividend period. The MOEX Index climbed 0.3%, and the RTS Index lost 0.6%.

AFTER THE RISE AT THE BEGINNING OF THE MONTH, EMES' CURRENCIES THEN ADJUSTED DOWNWARDS *Chart 9*
(02.01.2018 = 100)

EXCHANGE RATES IN ADVANCED ECONOMIES*



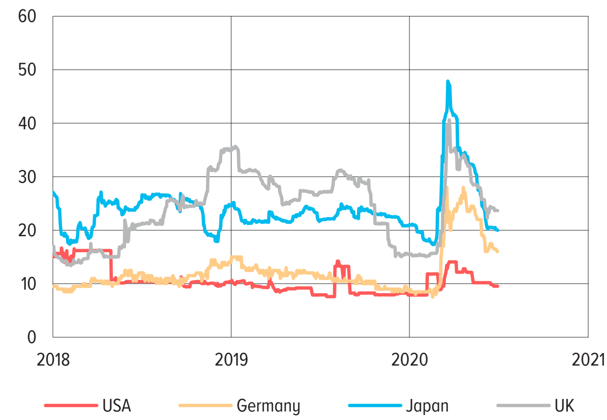
EXCHANGE RATES IN EMERGING MARKET ECONOMIES*



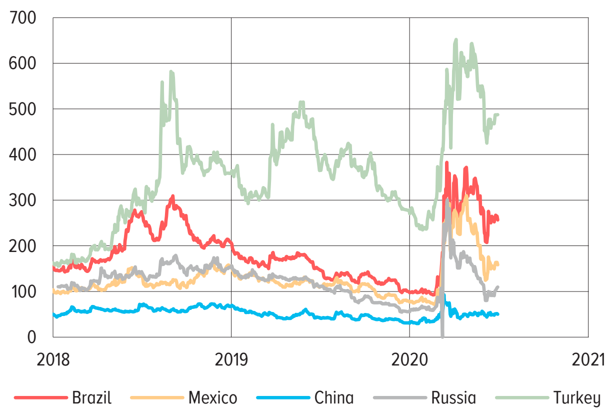
** Against the US dollar. Reverse exchange rates.*
Sources: Bloomberg, Bank of Russia calculations.

RUSSIA'S CDS SPREAD INCREASED IN CONTRAST TO MOST OTHER EMES *Chart 10*
(BP)

CDS OF ADVANCED ECONOMIES



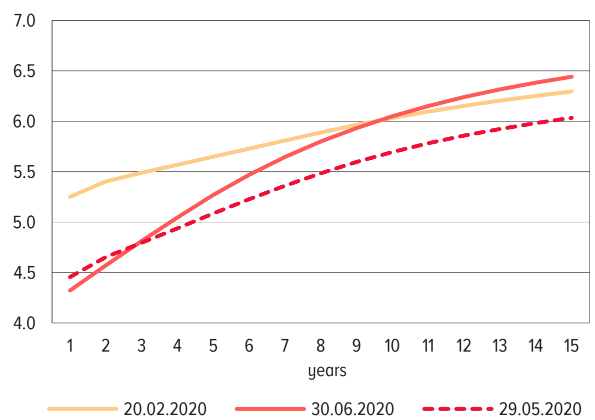
CDS OF EMERGING MARKET ECONOMIES



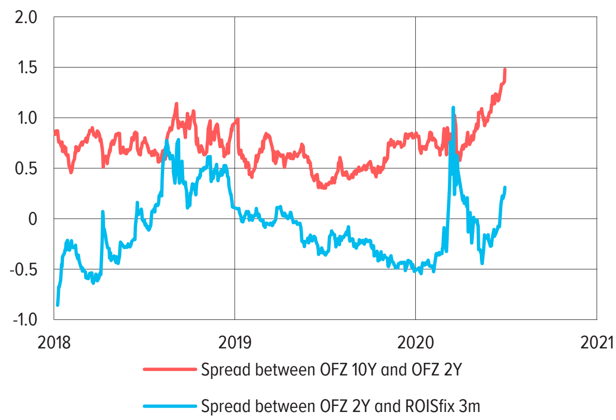
Sources: Bloomberg, Thomson Reuters, Bank of Russia calculations.

THE SLOPE OF THE OFZ YIELD CURVE REACHED ITS 2014 HIGH *Chart 11*

OFZ ZERO COUPON YIELD CURVE (% P.A.)



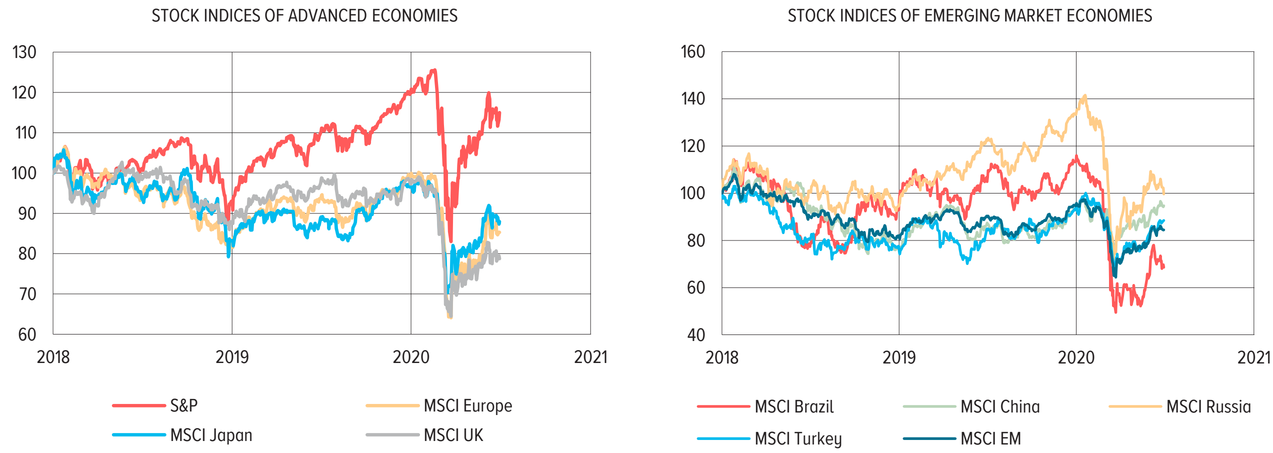
SPREAD MOVEMENTS (BP)



Source: PJSC Moscow Exchange.

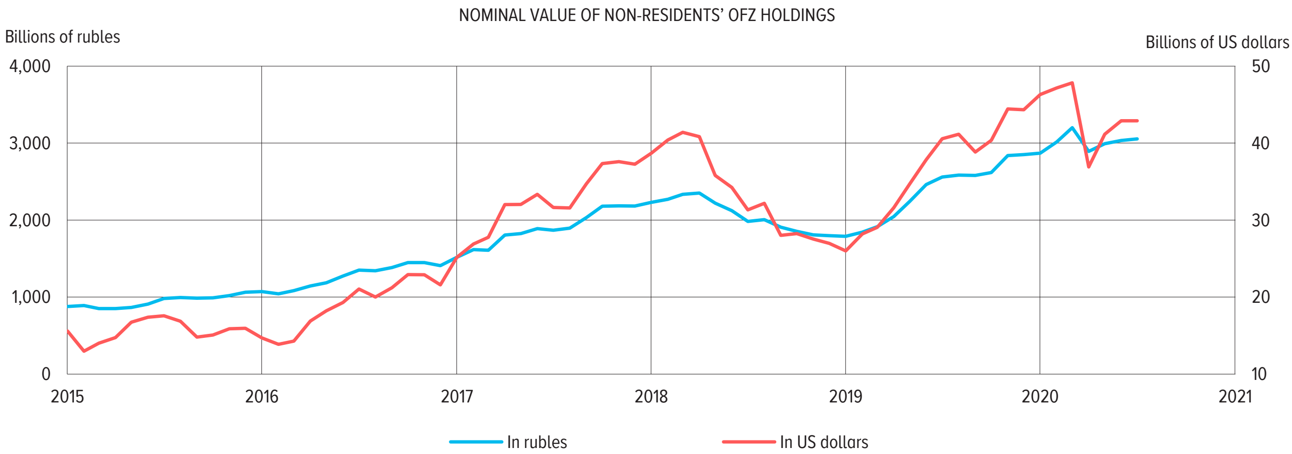
EMES' STOCK INDICES DEMONSTRATED HIGHER GROWTH VERSUS ADVANCED ECONOMIES *Chart 12*

(02.01.2018 = 100)



Sources: Bloomberg, Bank of Russia calculations.

FOREIGN INVESTORS' OFZ HOLDINGS CONTINUED TO BOUNCE BACK *Chart 13*



Source: Bank of Russia calculations.

THE RECOVERY OF RUSSIA'S MARKET SLOWED DOWN IN JUNE DUE TO ADVERSE CHANGES IN THE EXTERNAL ENVIRONMENT

Table 4

Indicator		30.06.2020	1M	3M	6M	YTD	1Y
Russian financial market							
RUB/USD exchange rate		71.19	-1.5	9.2	-14.8	-14.8	-12.6
MOEX Index		2,743	0.3	9.3	-9.9	-9.9	-0.8
RTS Index		1,213	-0.6	19.5	-21.7	-21.7	-12.2
Government bond yield		5.56	23	-115	-65	-65	-184
Corporate bond yield		5.96	-4	-169	-77	-77	-209
Regional bond yield		5.68	-16	-183	-59	-59	-247
CDS spread		110	-7	-83	54	54	-3
RVI		35	0	-37	13	13	13
Exchange rates (per US dollar, % change, '+' – appreciation, '-' – depreciation)							
AEs*	US Dollar Index	97.39	-1.0	-1.7	1.0	1.0	1.3
	Euro	1.12	1.2	1.8	0.2	0.2	-1.2
	Japanese yen	107.93	-0.1	-0.4	0.7	0.7	0.0
	Pound sterling	1.24	0.5	-0.2	-6.5	-6.5	-2.3
EMEs	JP Morgan EM Currency Index	54.29	-0.9	1.7	-11.6	-11.6	-13.6
	Ruble	71.19	-1.5	9.2	-14.8	-14.8	-12.6
	Brazilian real	5.47	-2.3	-4.7	-26.4	-26.4	-29.6
	Mexican peso	22.99	-3.6	3.1	-17.7	-17.7	-16.5
	Chinese yuan	7.06	1.0	0.2	-1.4	-1.4	-2.8
	Turkish lira	6.85	-0.5	-3.5	-13.2	-13.2	-15.5
	South African rand	17.35	1.1	2.8	-19.3	-19.3	-18.8
10-year bond yield (% p.a., change in bp, '-' – increase, '-' – decrease)							
AEs	USA	0.66	0	-1	-126	-126	-135
	Germany	-0.46	-1	2	-27	-27	-13
	Japan	0.02	2	1	4	4	18
	UK	0.17	-1	-18	-65	-65	-66
EMEs	Russia	5.91	36	-85	-46	-46	-151
	Brazil	6.71	-23	-110	2	2	-60
	Mexico	5.82	-31	-124	-107	-107	-175
	China	2.84	15	26	-30	-30	-39
	Turkey	11.46	-74	-138	-49	-49	-476
	South Africa	9.24	34	-173	22	22	41
CDS spreads (% p.a., change in bp, '-' – increase, '-' – decrease)							
AEs	USA	10	-1	-5	2	2	2
	Germany	16	-3	-7	7	7	5
	Japan	20	-5	-21	-1	-1	-2
	UK	24	-2	-11	8	8	-3
EMEs	Russia	110	-7	-83	54	54	-3
	Brazil	257	-27	-19	157	157	106
	Mexico	158	-19	-82	80	80	47
	China	50	-7	-2	19	19	7
	Turkey	487	-63	-53	210	210	93
	South Africa	303	-41	-104	141	141	136
Equity market (points, % change, '+' – increase, '-' – decrease)							
AEs	S&P	3,100	1.8	20.0	-4.0	-4.0	5.4
	MSCI Europe	1,534	3.9	14.3	-14.0	-14.0	-8.8
	MSCI Japan	945	0.0	11.4	-8.9	-8.9	1.0
	MSCI UK	1,746	1.4	7.8	-19.1	-19.1	-18.4
EMEs	MSCI EM	995	7.0	17.3	-10.7	-10.7	-5.7
	MSCI Russia	603	-2.3	17.6	-25.3	-25.3	-17.7
	MSCI Brazil	1,436	7.3	22.5	-39.5	-39.5	-35.3
	MSCI Mexico	3,386	-0.2	10.6	-28.8	-28.8	-26.8
	MSCI China	87	8.4	14.2	2.0	2.0	10.3
	MSCI Turkey	1,428,156	7.9	23.0	-5.0	-5.0	8.5
	MCSI South Africa	1,274	8.7	22.4	-7.1	-7.1	-9.9

** Advanced economies.*
Sources: Bloomberg, Moscow Exchange, Cbonds.ru, Bank of Russia calculations.

Credit and deposit market

Deposit rates. Tightening competition for depositors among banks, coupled with the local growth of market yields, which was pushing up the average market deposit rates in April, turned out to be temporary. Already in May, banks extensively started to readjust the cost of their deposit products downwards (Chart 14). Moreover, as in the related segments of the financial market, the renewed decline in interest rates affected both short- and long-term operations: over the month, interest rates on short- and long-term deposits lost 72 bp and 10 bp, thus decreasing to 4.1% and 4.9%, respectively.

In June, a range of credit institutions announced their seasonal deposit offers. However, the majority of banks still opted not to attract household deposits at increased interest rates, taking into account the actual and the expected reduction in yields on financial market instruments. Concurrently, market participants are gradually becoming more confident that the trend for keeping interest rates in the economy at their record lows will remain steady, which is supported by the Bank of Russia's decisions on cutting the key rate. This creates an extra space for a smooth decrease in the cost of retail bank funding in the near future.

Deposit operations. In May, the self-isolation regime continued to restrain households' saving activity and, as before, largely influenced how depositors were choosing to use their money. As a result, the growth of the retail deposit portfolio remained low in May, namely 6.4%[1] in annualised terms, causing further switches in its maturity structure.

Households were mostly reluctant to deposit funds for long terms: on the one hand, they preferred to keep available funds to be able to cover their current expenses; on the other hand, individuals were seeking to make advantage of April's significant rise in interest rates in the short-term market segment. Consequently, for the first time since early 2018, the contribution of long-term ruble deposits to the growth of the overall deposit portfolio became negative, while short-term deposits continued to strengthen their position as the principal market driver (Chart 15). Furthermore, individuals' demand for foreign currency deposits remained weak since interest rates in this market segment stayed at their record lows. This also continued to affect the growth of the retail deposit portfolio and, coupled with the strengthening of the ruble, contributed to the progressive reduction in the portion of foreign currency deposits in the retail portfolio to 20.2%, which is close to early 2020 readings.

Provided there are no new cases of a drastic deterioration in external and internal economic conditions and as the quarantine restrictions are cancelled, short-term operations may be expected to gradually reduce their influence on trends in the retail deposit market. This may be accompanied by a recovery of interest in long-term deposits, including those offered within complex deposit products that may become more requested if the downward trend in interest rates persists.

Credit rates. In April 2020, the cost of short-term borrowings in the corporate segment[2] decreased by 0.1 pp, to 7.7%, as the portion of such loans in total disbursements expanded as a result of the implementation of the programmes supporting socially important segments of the retail market amid the coronavirus pandemic. Concurrently, interest rates on short-term loans to small and medium-sized enterprises (SMEs) trended up, which could be explained by both increased credit risk and the specifics of the statistical accounting of zero interest rate wage loans that are excluded from the calculation of the average market rates. The long-term lending segment demonstrated a rise in interest rates for the second consecutive month. This was driven by the response to the upward adjustment of yields on financial market instruments in

[1] *Hereinafter, increases in banks' balance sheet indicators are calculated based on the reporting data of operating credit institutions recorded in the State Register as of the relevant reporting date. Increases in foreign currency claims and liabilities are calculated in US dollar terms. Where increases in the indicators comprising foreign currency and ruble components are calculated herein, the growth of the foreign currency component is converted into rubles using the period average exchange rate.*

[2] *Hereinafter, the corporate segment of the credit market implies lending to non-financial organisations.*

March, the increase in the risk premium, and the moderate growth of the portion of long-term SME loans in the market turnover (Chart 14).

In the next few months, the average market interest rates on corporate loans will presumably maintain diverse trends. On the one hand, increased credit risk amid economic uncertainty will continue to push interest rates upwards. On the other hand, they will be driven downwards by the actual easing of monetary policy, expectations for a further key rate reduction until the end of 2020, and the progressive expansion of the lending support programmes.

In the retail segment of the credit market, interest rates on short-term loans involving higher risk resumed the downward trend, after the spike in April. Specifically, the average market rate on loans with maturities of up to one year dropped by 0.4 pp in May. Moreover, the interest rate on ruble-denominated housing mortgage loans decreased by 0.9 pp in May, hitting a new record low of 7.4%. Such a material reduction in the interest rate in this segment of the retail lending market amid the easing of monetary policy was caused by the implementation of the governmental preferential mortgage lending programmes.

In the next few months, the average market interest rates on mortgage loans may be expected to lower further. This reduction will be driven by the governmental support of mortgage lending, coupled with attractive programmes offered by individual banks with interest rates subsidised by developers, as well as by June's key rate decrease. As to the segments, other than mortgage lending, the reduction in the cost of borrowings resulting from the monetary policy easing may be limited since banks have become more cautious in selecting their borrowers due to increased credit risks.

Corporate lending. In March–April 2020, the growth of corporate lending was mostly boosted by short-term operations, and in May this trend remained. As of the end of the month, the annual increase in the portfolio of loans to non-financial organisations totalled 4.8%, staying close to its level recorded in the previous month. The growth of ruble-denominated loans with maturities of up to one year sped up by 1.5 pp, to reach 12.6% (Chart 16). The steady expansion of the corporate loan portfolio was aided by, among other factors, the implementation of the governmental programmes supporting the industries most affected by the coronavirus pandemic. Moreover, non-financial organisations still preferred not to build up their foreign currency liabilities amid increased macroeconomic uncertainty. Consequently, as of the end of May, the portfolio of corporate foreign currency loans shrank by 1.6% in annualised terms.

The quality of the corporate loan portfolio remained almost the same as in the previous month. This became possible owing to the settlement of overdue debt obligations through loan restructuring programmes available to the borrowers hit by the coronavirus. As a result, the portion of overdue loans to non-financial organisations equalled 7.5% as of the end of May, compared to 7.4% the month before (Chart 16).

In the next few months, the corporate lending portfolio may be expected to remain stable owing to the governmental programmes supporting lending to non-financial organisations and the easing of monetary policy pushing the cost of borrowings downwards. However, the growth of lending will be hindered due to increased credit risk, banks' cautiousness in selecting borrowers, and the use of alternative financing sources by corporates.

Retail lending. After a 0.7% reduction in April 2020, the retail loan portfolio showed a slight increase by 0.2% in May. This recovery of the retail loan portfolio was mostly driven by operations with maturities exceeding three years, which was associated with mortgage lending trends. Specifically, mortgage loans disbursed in May approximated 200 billion rubles. As of the end of the month, the annual growth of the mortgage loan portfolio[3] equalled 13.6%. Therefore, the slowdown in the annual growth over the month turned out to be less notable than in April 2020. Mortgage lending that remained the key driver of the retail credit market was supported by the governmental preferential mortgage lending programmes and banks' steady interest in this low-risk market segment (Chart 17).

[3] *Housing mortgage loans, net of claims on such loans acquired by banks.*

It is possible that the portfolio of mortgage loans will smoothly slow down its growth in the short run as demand declines due to uncertainty regarding economic developments. However, mortgage lending will preserve its potential for sustainable growth owing to record low interest rates in mortgage lending, resulting from the implementation of the governmental mortgage support programmes, and the rise in the average loan principal driven by the increase in the maximum amount of a preferential 6.5% mortgage loan.

The retail lending segments involving high risk continued to contract in May. Specifically, outstanding unsecured consumer loans decreased by 19 billion rubles, compared to a reduction by 155.1 billion rubles the month before; and outstanding car loans shrank by 13.7 billion rubles after a decline by 30.6 billion rubles in April. Amid higher uncertainty, borrowers still preferred to repay their loans and not to increase new liabilities. In turn, banks became more prudent in selecting their potential clients due to the deterioration of borrowers' financial standing caused by the coronavirus pandemic, and tightened their non-price lending conditions as early as the end of 2020 Q1 (Chart 18). Therefore, May's trends in consumer lending suggest that the earlier granted loans were either repaid by borrowers, or reclassified as overdue by banks. Thus, individuals' overdue ruble-denominated loans increased by 25.3 billion rubles, and the portion of overdue loans in the retail portfolio expanded by 0.1 pp, to 4.7% (Chart 16). The portfolio of unsecured consumer loans shrank less significantly in May, which was associated with the gradual revival of activity in the high-risk credit card segment: after the considerable reduction in the previous month, demand loans positively contributed to the expansion of the retail loan portfolio in May.

In the next few months, the portfolio of consumer loans may be expected to demonstrate sluggish dynamics. In annualised terms, the slowdown in retail lending will be still primarily driven by consumer lending.

Money supply. In May, the growth of the banking system's claims on the economy[4] continued to gradually decelerate, mostly due to weaker activity in the retail segment of the credit market. The annual growth of claims on households slowed down by 1.4 pp over the month, declining to 12.6%. Conversely, the banking system's claims on businesses generally preserved the previous month's trend, rising by 6.7% in annualised terms.

As budget spending accelerated for the first time since 2017, the banking system's claims on the general government stopped to hinder the growth of money supply. Coupled with the steadily important role of claims on the economy, this helped maintain the annual growth of broad money and money supply in the national definition close to their local highs of 9.3% and 13.6%, respectively, against 9.6% and 14.0% in April (Chart 19).

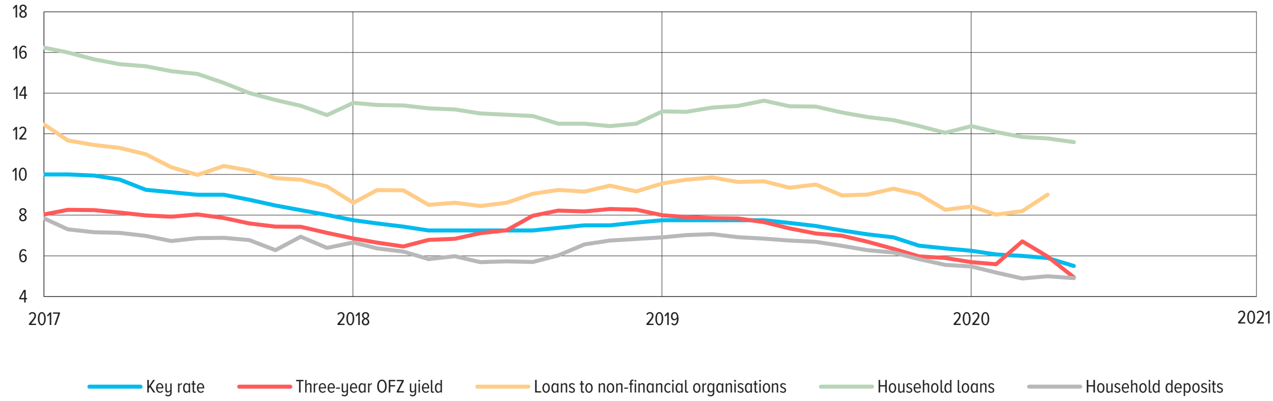
As before, the structure of money supply was dominated by ruble deposits of the non-financial sector. In addition, demand deposits significantly increased their influence as uncertainty about macroeconomic prospects amid the coronavirus pandemic amplified temporarily. This was also the reason why demand for cash remained high, in contrast to the recent years' trend. Along with the 2019 low base, this spurred the annual growth of the M0 aggregate to 23% as of the end of May.

[4] Banking sector claims on the economy mean all claims of the banking system on non-financial and financial organisations and households in Russian rubles, foreign currency, and precious metals, which include loans extended (including overdue loans), overdue interest on loans, credit institutions' investment in debt and equity securities and promissory notes, as well as other forms of participation in non-financial and financial organisations' equity, and other receivables under settlement operations with non-financial and financial organisations and households.

THE KEY RATE REDUCTION AND DECLINING OFZ YIELDS CREATE CONDITIONS FOR A DECREASE IN DEPOSIT AND LENDING RATES

Chart 14

INTEREST RATES ON BANKS' LONG-TERM RUBLE TRANSACTIONS (% P.A.)

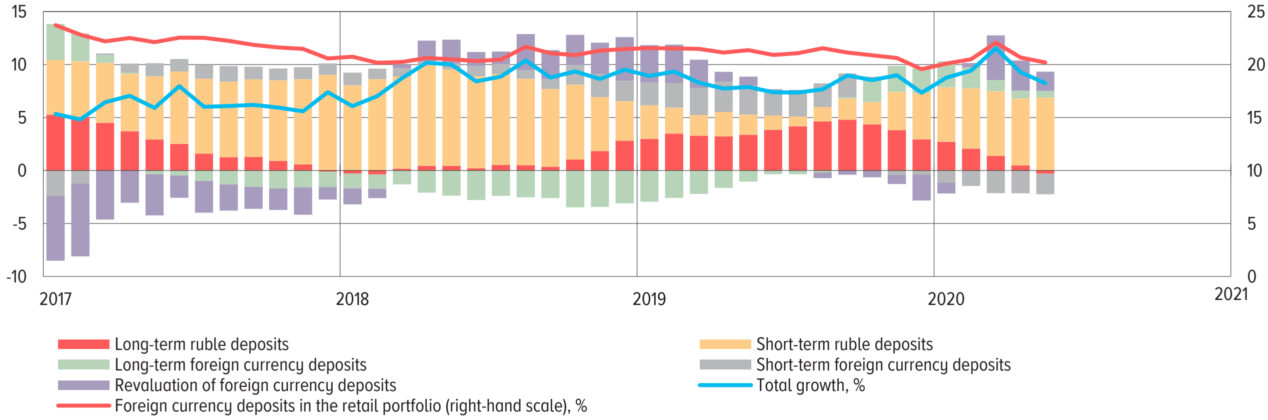


Source: Bank of Russia.

IN MAY, HOUSEHOLDS' NEED FOR FUNDS TO COVER THEIR CURRENT EXPENSES INCREASED DUE TO THE QUARANTINE, WITH BALANCES IN THE LONG-TERM RUBLE DEPOSIT SEGMENT SHRINKING

Chart 15

CONTRIBUTION OF INDIVIDUAL COMPONENTS TO THE ANNUAL GROWTH OF HOUSEHOLD DEPOSITS, PP

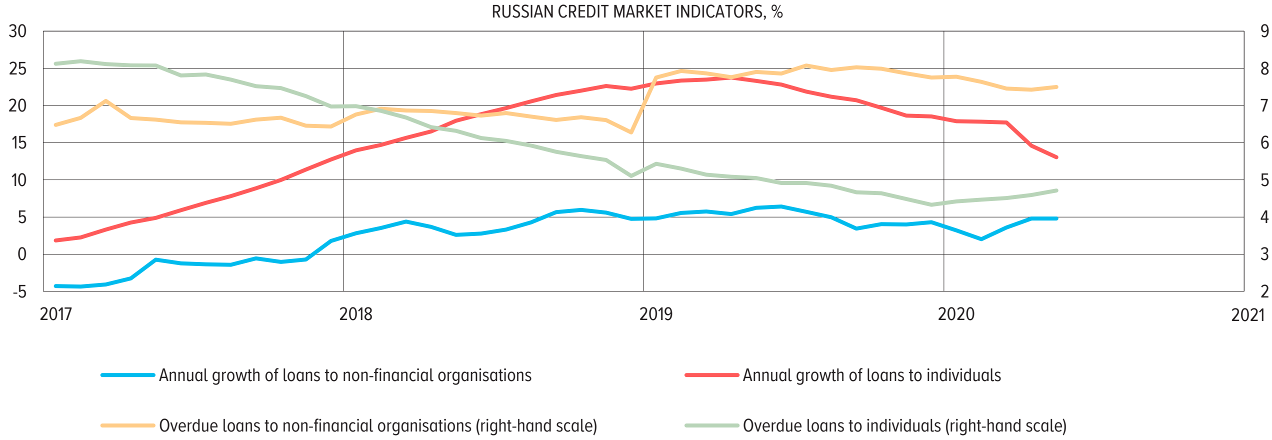


Source: Bank of Russia calculations.

CORPORATE LENDING REMAINED STABLE IN MAY, WHILE RETAIL LENDING CONTINUED TO SLOW DOWN, WITH OVERDUE DEBT RISING IN THIS SEGMENT

Chart 16

RUSSIAN CREDIT MARKET INDICATORS, %

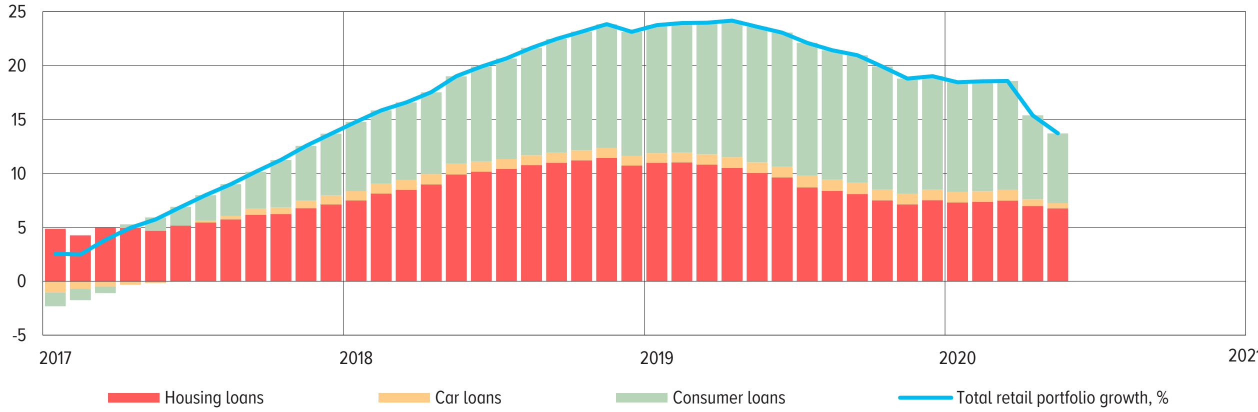


Source: Bank of Russia calculations.

MORTGAGE LENDING REMAINED THE KEY DRIVER OF THE RETAIL LENDING MARKET OWING TO THE GOVERNMENTAL MORTGAGE SUPPORT PROGRAMMES

Chart 17

CONTRIBUTION OF INDIVIDUAL COMPONENTS TO THE ANNUAL GROWTH OF THE RETAIL LOAN PORTFOLIO*, PP

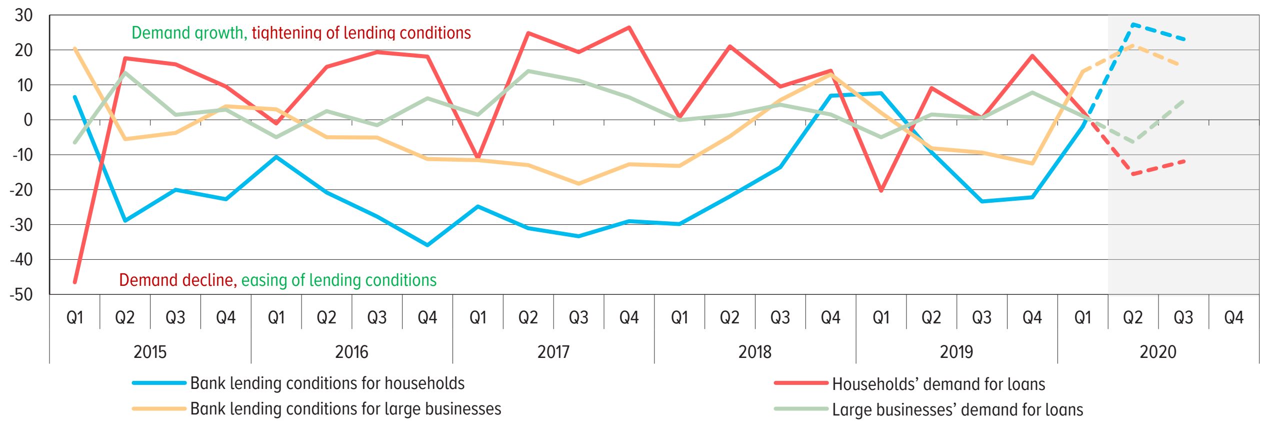


** For loans grouped into homogeneous loan portfolios.*
Source: Bank of Russia calculations.

IN 2020 Q1, BANKS TIGHTENED THEIR REQUIREMENTS FOR BORROWERS' FINANCIAL STANDING

Chart 18

INDICES OF LENDING CONDITIONS AND DEMAND FOR LOANS, PP

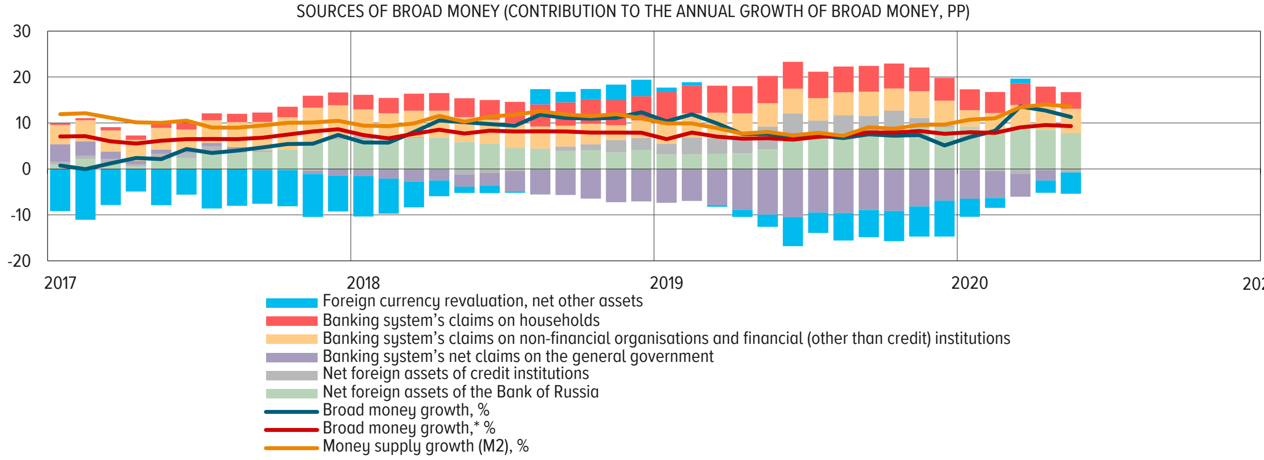


Source: Bank of Russia.

IN MAY, BUDGET OPERATIONS STOPPED TO HINDER MONEY SUPPLY GROWTH

Chart 19

SOURCES OF BROAD MONEY (CONTRIBUTION TO THE ANNUAL GROWTH OF BROAD MONEY, PP)



** Adjusted for foreign currency revaluation.*
Source: Bank of Russia.

CREDIT AND DEPOSIT MARKET INDICATORS *Table 5*

		February 2020	March 2020	April 2020	May 2020
Rates on banks' long-term ruble transactions					
– household deposits	% p.a.	5.2	4.9	5.0	-
– household loans	% p.a.	12.1	11.8	11.8	-
– corporate loans	% p.a.	8.0	8.2	9.0	-
Household deposits	**% YoY, AFCR**	**9.0**	**7.3**	**6.4**	**6.4**
– in rubles	% YoY	10.8	10.7	9.9	9.8
– in foreign currency	% YoY	2.3	-4.6	-6.2	-5.9
– share of foreign currency	%	20.5	22.1	20.7	20.2
Loans to non-financial organisations	**% YoY, AFCR**	**2.0**	**3.6**	**4.8**	**4.8**
– short-term (up to 1 year)	% YoY, AFCR	3.3	9.8	12.4	13.9
– long-term (more than 1 year)	% YoY, AFCR	1.9	2.3	3.2	3.1
– overdue loans	%	7.6	7.5	7.4	7.5
Household loans	**% YoY, AFCR**	**17.8**	**17.7**	**14.6**	**13.0**
– housing mortgage loans	% YoY, AFCR	15.4	15.2	14.1	13.6
– unsecured consumer loans	% YoY	20.2	20.0	15.3	12.7
– overdue loans	%	4.5	4.5	4.6	4.7
Banking system's claims on the economy	**% YoY, AFCR**	**7.9**	**9.1**	**8.6**	**8.2**
– on businesses	% YoY, AFCR	4.9	6.3	6.7	6.7
– on households	% YoY, AFCR	16.6	16.8	14.0	12.6
Money supply (monetary aggregate M2)	**% YoY**	**11.0**	**13.4**	**14.0**	**13.6**
Broad money	**% YoY, AFCR**	**7.9**	**9.1**	**9.6**	**9.3**

Note: YoY – year-over-year; AFCR – adjusted for foreign currency revaluation. The Marshall-Edgeworth decomposition is used to make the adjustment for foreign currency revaluation.
Source: Bank of Russia calculations.

Data cut-off dates:
- 'Banking sector liquidity and money market' section – 07.07.2020 (The reserve requirements are an important part of the Bank of Russia's instruments for managing banking sector liquidity and money market rates. Therefore, the operational procedure of the Bank of Russia's monetary policy should be analysed for efficiency with account of the required reserves averaging periods. In June–July 2020, this period is from 10.06.2020 to 07.07.2020);
- 'Foreign exchange and stock markets' section – 30.06.2020;
- 'Credit and deposit market' section – 01.06.2020.

A soft copy of the information and analytical commentary is available on the Bank of Russia website.
Please send your comments and suggestions to svc_analysis@cbr.ru.
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