Bank of Russia
The Central Bank of the Russian Federation

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**September 2018**

# Banking sector liquidity and financial markets

**Facts, assessments and comments**

**Moscow**

Cut-off date:
'Banking sector liquidity and money market'* section – 9 October 2018;
'Foreign exchange and stock market' section – 28 September 2018.

* Reserve requirements are an important part of the Bank of Russia's set of tools for managing banking sector liquidity and money market rates. Therefore, an analysis of the effectiveness of the Bank of Russia's monetary policy operational procedure should take into account required reserves averaging periods. In September 2018, this is the period between 05/09/2018 and 09/10/2018.

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Please send your comments and suggestions to *svc_analysis@cbr.ru.*

# Banking sector liquidity and financial markets: facts, assessments and comments
*(September 2018)*

- ***At the end of September, the structural liquidity surplus declined slightly as the Bank of Russia suspended fiscal rule-based foreign currency purchases in the domestic market.***
- ***The spread of interbank lending rates to the Bank of Russia key rate widened amid a temporary change in the structure of transactions conducted by large money market participants.***
- ***The situation with FX liquidity improved a little given increased current account revenue and suspension of fiscal rule-based foreign currency purchases.***
- ***The Russian financial market saw a stabilisation in September. These developments came on the back of the following factors: recovery in demand for emerging markets' assets, growing global oil prices, and the Bank of Russia's decisions to raise the key rate and suspend fiscal rule-based foreign currency purchases through the end of 2018.***
- ***With the September key rate increase by the Bank of Russia being unexpected for many market participants, their forecast key rate path has shifted upwards by 25-50 bp over a one-year horizon.***

## Banking sector liquidity and money market

**At the end of September, the structural liquidity surplus declined slightly as the Bank of Russia suspended fiscal rule-based foreign currency purchases in the domestic market[1].** Significant tax payments by banks' clients from their bank accounts to budget accounts with the Bank of Russia representing additional oil and gas budget revenue received due to the actual Urals crude price considerably exceeding 40 US dollars per barrel were not matched by equivalent foreign currency purchases. Banks' growing demand for liquidity was also supported by a pick up in the amount of required reserves banks had to maintain at the Bank of Russia – as a result of increased required reserve ratios under credit institutions' foreign currency liabilities[2].

A certain inflow of liquidity was caused by banks' growing outstanding amounts under Federal Treasury deposits and repos. Banks mainly attract funds for long terms, however the end of September saw a surge in certain banks' demand for one-day Federal Treasury repos (Charts 3 and 4).

**The spread of short-term interbank lending rates to the Bank of Russia key rate widened from 17 to 24 bp (Chart 5).** This was due to a drop in certain large market participants' demand for ruble liquidity and the emergence of a temporary liquidity surplus in the market under the influence of the following factors. For the most of the month, these banks' outstanding amounts on Bank of Russia standing lending facilities secured by non-marketable assets were high. In doing so, the banks replaced their borrowings in the money market. As for other market participants, the structure of their operations did not change immediately. As a result, banks did not increase the amount of funds placed on Bank of Russia seven-day deposit auctions, they rather maintained their correspondent account balances high during the larger part of the required reserve averaging period, which caused a temporary drop in demand in the money market.

Tax payments did not exert any material upward pressure on rates during the averaging period under consideration. As earlier, Bank of Russia fine-tuning deposit auctions helped to maintain interbank lending rates close to the key rate in September. Over several coming months, the spread may be narrowed following a reduction in the structural liquidity surplus (Table 2) as a result of Bank of Russia suspended foreign currency purchases under the fiscal rule.

**At the end of the September averaging period, the spread between the interbank lending rate and the FX swap rate narrowed, which implied a certain improvement in the FX liquidity situation.** The inflow of foreign currency to the banking sector resulted from persistently high current account revenue which was not spent on foreign currency purchases by the Bank of Russia in the domestic FX market under the fiscal rule. Early September saw a considerable temporary widening in the spread between interbank lending rates and FX swap rates, as well as an increase in the demand for Bank of Rus-

[1] For details see information and analytical commentary 'Banking sector liquidity and financial markets. No. 30. August April 2018' and the Bank of Russia's commentary on operations under the fiscal rule dated 14 September 2018.

[2] See the Bank of Russia's press-release dated 23 July 2018 'On amending required reserve ratios'.

sia sell/buy FX swap operations. This was explained by a squeeze in the foreign currency supply amid a decline in foreign currency liquidity at several large banks caused by changes in the structure of customer operations. However, this foreign currency outflow was transitory and was subsequently offset by the inflow of foreign currency deposits taken by other banks.

**Compared with the forecast presented in the previous issue, the assessment of the structural liquidity surplus as of year-end 2018 remained unchanged at 1.7-2.1 trillion rubles** (Table 2).

**With the key rate increase by the Bank of Russia in September coming unexpected for many market participants**, their expected key rate path shifted upwards by 25-50 bp over a one-year horizon. Market prices of a number of instruments reflect the expected rate increase by 50-75 bp within the next 12 months.

**Table 1**

**Expected interest rate path based on market instruments increased noticeably**

| **1. Expectations based on market indicators*** *interest rate (instrument)* | *January 2019* | *April 2019* | *July 2019* |
|---|---|---|---|
| - MosPrime 3M (FRA) | 8.86 (6.13) | 7.73 (7.94) | 8.08 (8.29) |
| - RUONIA (ROISfix) | 7.93 (7.53) | 8.35 (7.62) | 8.35 (7.62) |
| - RUONIA (futures) | 7.86 (7.58) | 8.10 (7.62) | 8.20 (7.71) |
| **2. Analysts' expectations for the key rate*** | *As of 31.12.2018* | *As of 31.03.2019* | *As of 30.06.2019* |
| - Bloomberg survey | 7.5 (7.13) | 7.5 (7.25) | 7.38 (7.0) |
| - Reuters survey | 7.5 (7.25) | 7.5 (7.25) | 7.5 (7.25) |
| **3. Implied inflation rate (OFZ-IN)** *(until 16 August 2023)* | 5.27 (5.16) | | |

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

*Source: Bank of Russia calculations.*

**Table 2**

**Structural surplus forecast has been upgraded on the basis of actual data for September**

| *(trillions of rubles)* | September 2018 | January-September 2018 | 2018 (forecast) |
|---|---|---|---|
| **1. Liquidity factors** *(supply)* | **-0.2** | **0.8** | **[-0.2; 0.1]** |
| - changes in the balances of general government accounts with the Bank of Russia, and other operations* | -0.2 | 0.7 | [0.2; 0.4] |
| - change in cash in circulation | 0.0 | -0.3 | [-0.8; -0.7] |
| - Bank of Russia interventions in the domestic FX market and monetary gold purchases** | 0.1 | 0.5 | 0.5 |
| - regulation of banks' required reserves with the Bank of Russia | 0.0 | -0.1 | -0.1 |
| **2. Change in free bank reserves (correspondent accounts)** *(demand)* | **0.2** | **0.1** | **[0.3; 0.4]** |
| **3. Change in banks' claims on deposits with the Bank of Russia and coupon OBRs** | **0.0** | **1.0** | **[-0.7; -0.2]** |
| **4. Change in outstanding amounts on Bank of Russia refinancing operations (4 = 2 + 3 – 1)** | **0.4** | **0.3** | **[0.0; 0.1]** |
| **Structural liquidity deficit (+) / surplus (-) (as of the period-end)** | **-3.1** | | **[-2.1; -1.7]** |

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

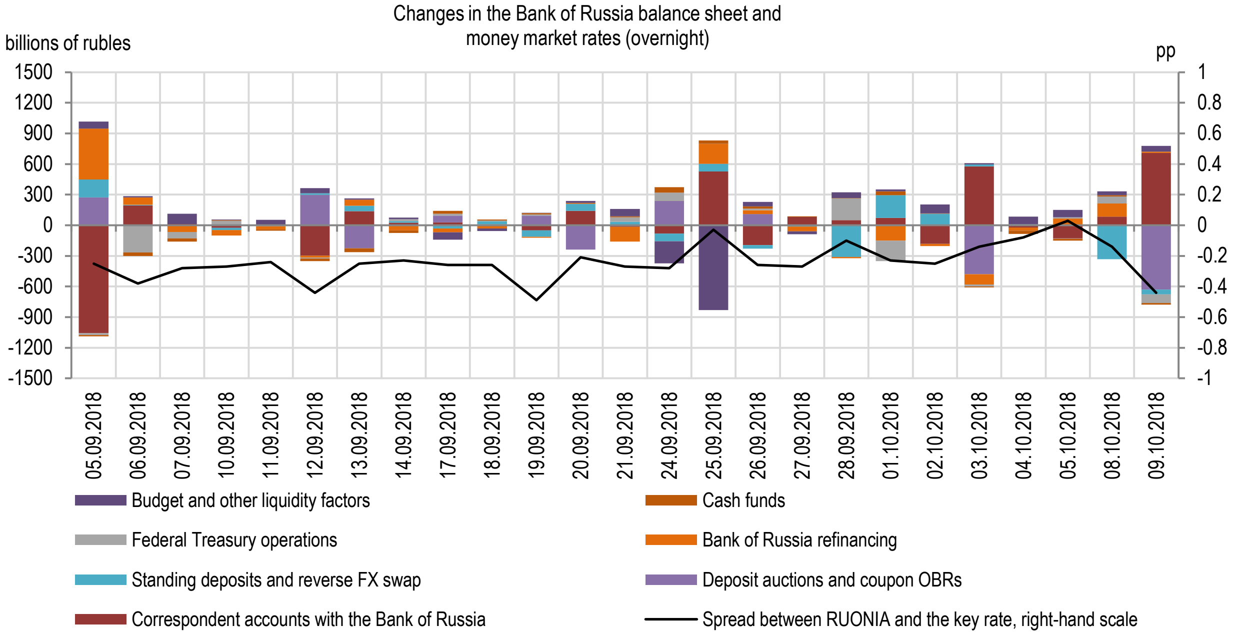
*** Forecast values of the indicator correspond to the actual volume of operations conducted.*

*Source: Bank of Russia calculations.*

**Chart 1**

**September 2018 saw an outflow of funds from banks through the budget channel as the Bank of Russia suspended foreign currency purchases in the domestic market under the fiscal rule**

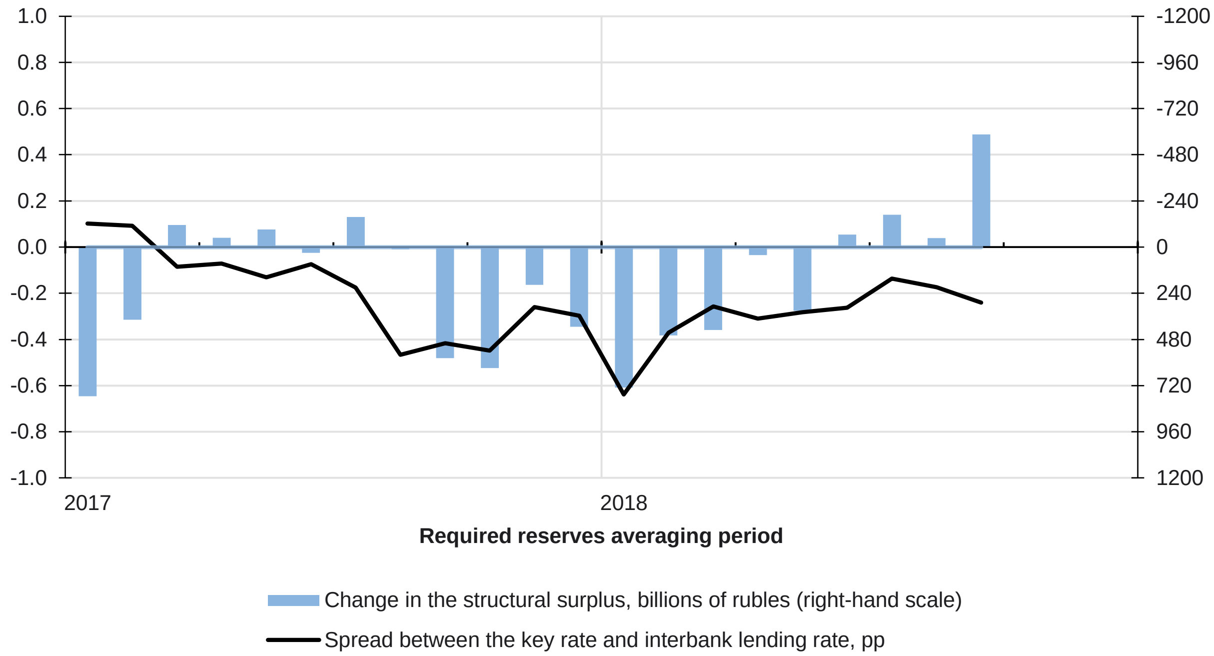
Changes in the Bank of Russia balance sheet and money market rates (overnight)




*Source: Bank of Russia calculations.*

**Chart 2**

**In subsequent months, the narrowing of the spread between the interbank lending rate and the key rate may be assisted by a reduction in the structural liquidity surplus**

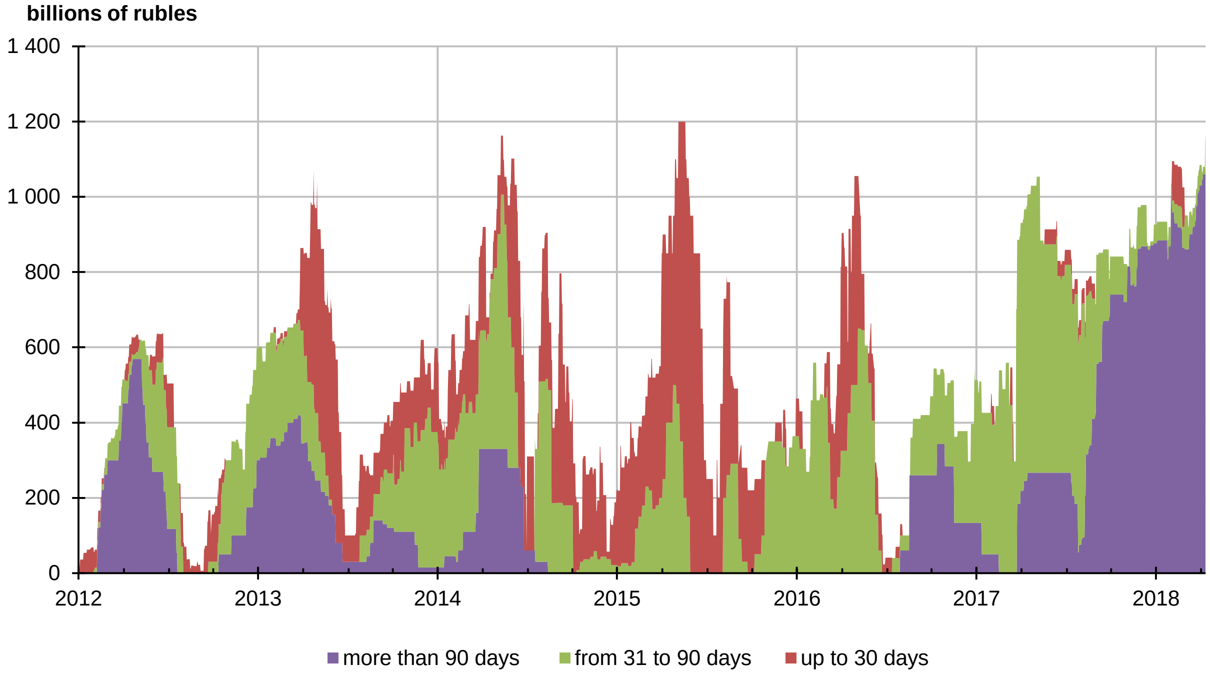



*Source: Bank of Russia calculations.*

Chart 3

**Banks mainly attract funds via long-term operations of the Federal Treasury**

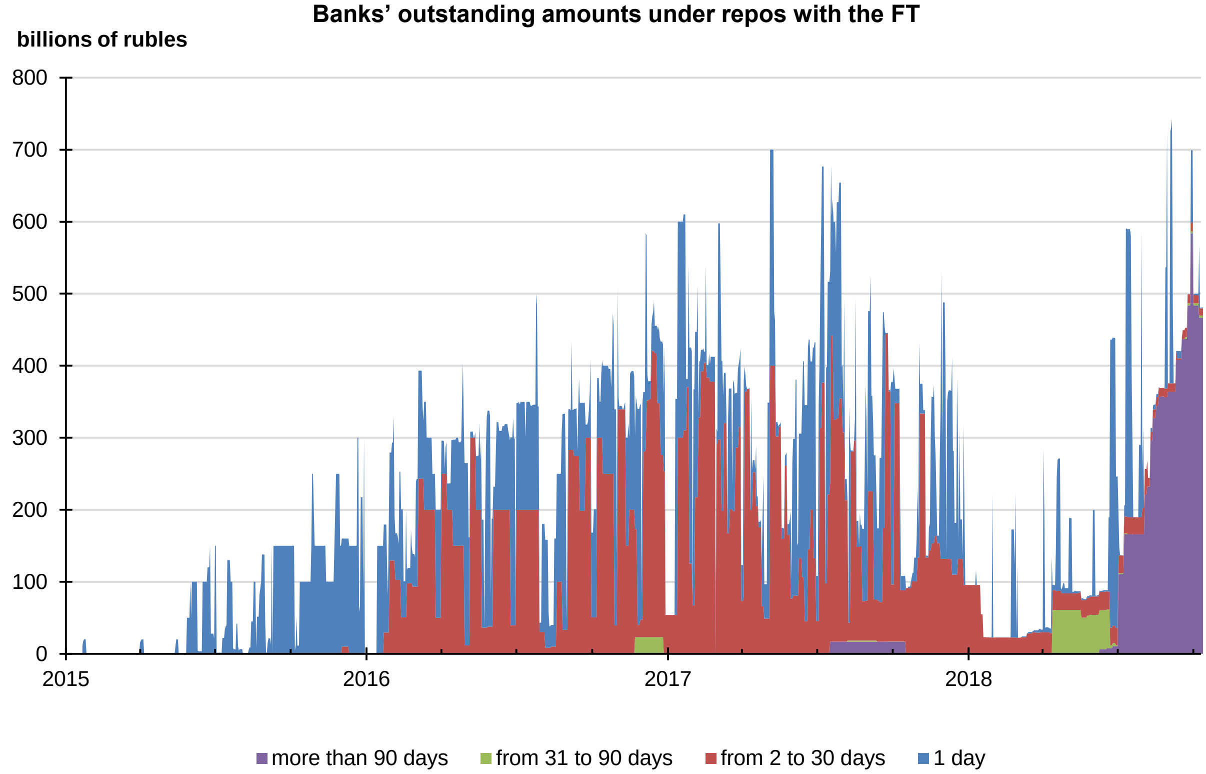
**Banks' outstanding amounts under deposits of the FT**




*Sources: Federal Treasury, Bank of Russia calculations.*

Chart 4

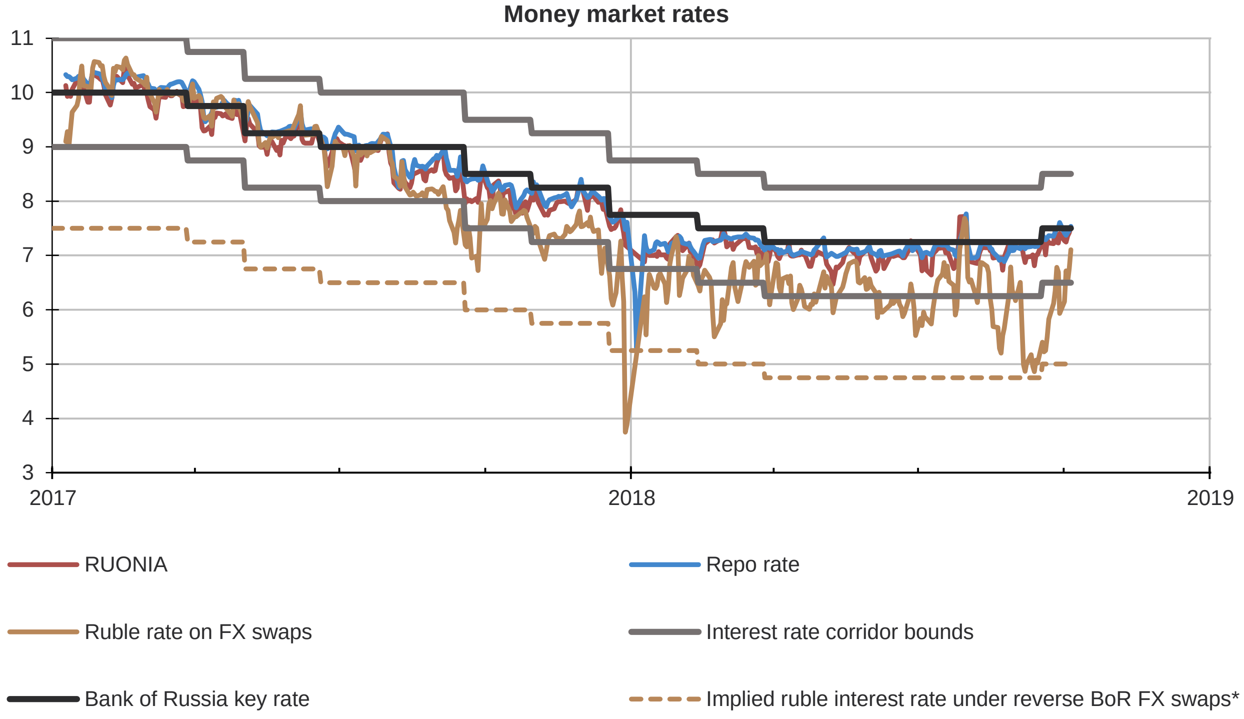
**Banks' outstanding amounts under repos with the FT**




*Sources: Federal Treasury, Bank of Russia calculations.*

**Chart 5**

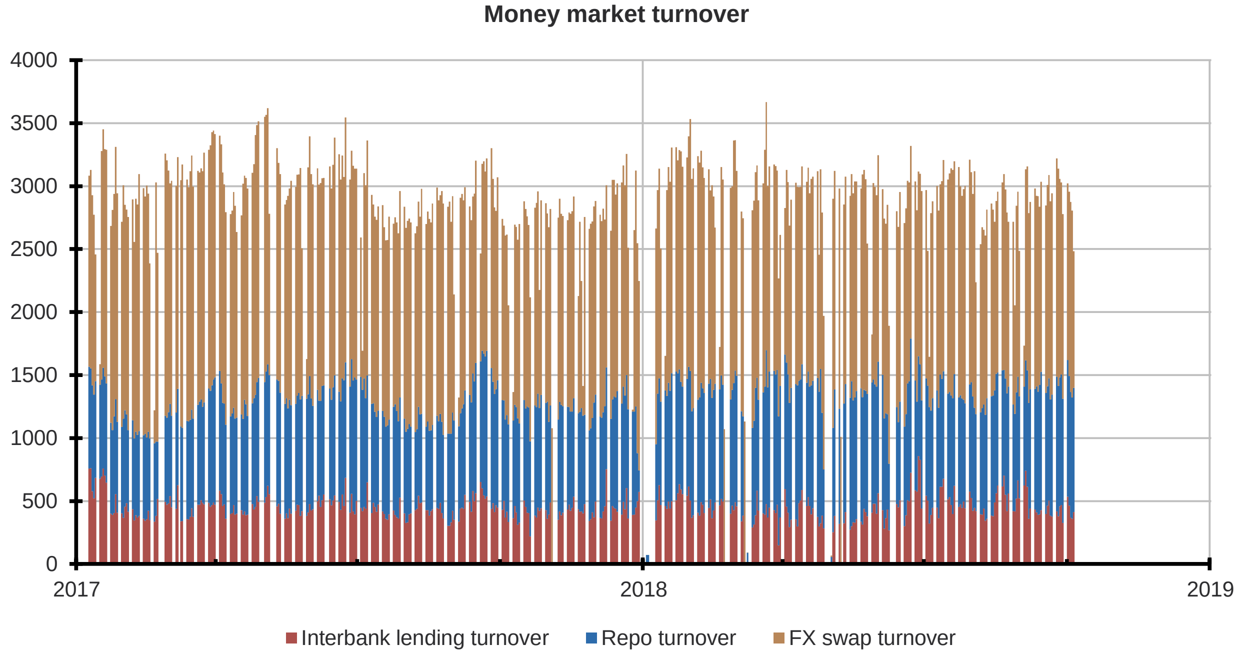
**During the September averaging period, the spread between interbank interest rates and the Bank of Russia key rate widened**




** Implied rate = ruble lending rate – FX borrowing rate + LIBOR*
*(Since 19.12.2016: key rate – 1 pp – (LIBOR + 1.5 pp) + LIBOR = key rate – 2.5 pp)*
*Source: Bank of Russia calculations.*

**Chart 6**

**Money market turnover remained stable**




*Source: Bank of Russia calculations.*

Table 3

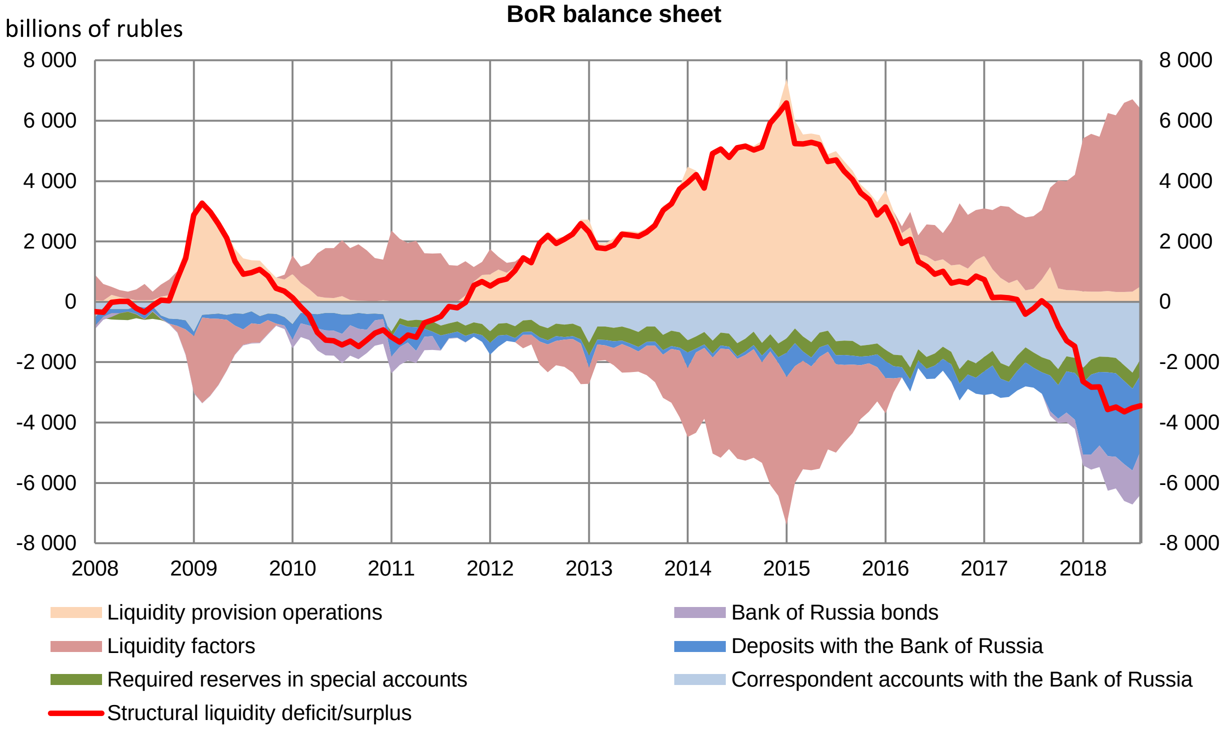
**In September 2018, the banking sector's structural liquidity surplus decreased**

| *(start of business, trillions of rubles)* | 01.10.2018 | 01.09.2018 | 01.01.2018 |
|---|---|---|---|
| **Structural liquidity deficit (+) / surplus (-)** | **-3.1** | **-3.4** | **-2.6** |
| **Bank of Russia standard monetary policy instruments** | | | |
| **Bank of Russia claims on credit institutions** | **0.4** | **0.0** | **0.0** |
| • Auction-based facilities | **0.0** | **0.0** | **0.0** |
| - repos and FX swaps | 0.0 | 0.0 | 0.0 |
| - secured loans | 0.0 | 0.0 | 0.0 |
| • Fixed interest rate facilities | **0.4** | **0.0** | **0.0** |
| - repos and FX swaps | 0.0 | 0.0 | 0.0 |
| - secured loans | 0.4 | 0.0 | 0.0 |
| **Credit institutions' claims on the Bank of Russia** | **3.8** | **3.7** | **2.7** |
| • Deposits | **2.3** | **2.3** | **2.4** |
| - auction-based | 1.8 | 2.1 | 2.1 |
| - fixed interest rate | 0.5 | 0.2 | 0.2 |
| • Bank of Russia bonds | **1.5** | **1.4** | **0.4** |
| **Standing reverse facilities other than Bank of Russia standard monetary policy instruments*** | | | |
| • Net claims of credit institutions and the Bank of Russia | **0.3** | **0.3** | **0.1** |

** 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.*

Chart 7




*Source: Bank of Russia calculations.*

## Foreign exchange and stock market

**In September, the situation in the Russian financial market stabilised under the influence of both external and internal factors.** The external factors include increasing oil prices and a cautious recovery in the demand for risk assets linked to improvements in the situation in Turkey and Argentina. Decisions made by the central banks of these two states to raise appreciably their policy rates put a halt to the depreciation of their national currencies and helped to reduce risk premiums. Key internal factors are Bank of Russia decisions to raise the key rate and to suspend foreign currency purchases under the fiscal rule through the end of 2018.

**The exchange rate.** After a sizeable drop at the beginning of the month (up to 70.5 rubles per 1 US dollar on 10 September), the ruble managed to recover its losses. At the end of the month, the ruble demonstrated better dynamics than other EME currencies gaining 3.1% compared to a 1.7% increase on average registered for other EMEs. An additional support for the ruble came from a declining demand for foreign currency on the part of foreign investors who were gradually restoring their long ruble positions in the FX swap market.

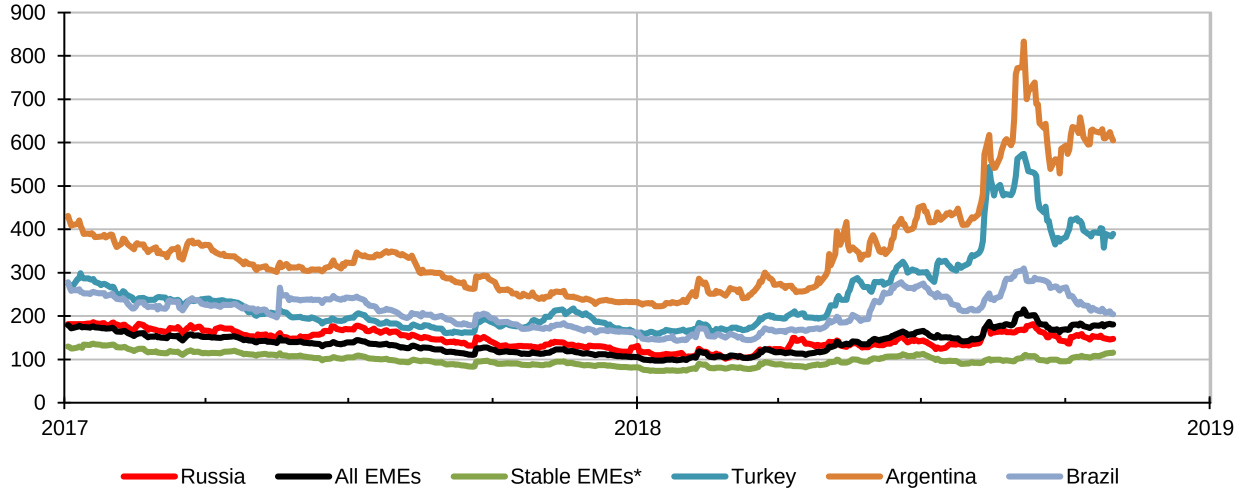
**Country risk premium.** After reaching a local high in early September, the CDS spread for Russia began to decline and stood at 143 bp by the end of the month. The total drop over the month was 24 bp, whereas the average premium for other emerging market economies (hereinafter, EMEs) (excluding Turkey, Argentina and Brazil) fell by 8 bp. The difference in the CDS premium dynamics between Russia and most EMEs may be explained by the stabilisation in the Russian FX market, growth in global oil prices and a somewhat less aggressive sanctions rhetoric.

**OFZ.** In the federal government bonds market, despite the continuing net sales of bonds by foreign investors (roughly 45 billion rubles, according to exchange data), OFZ yields declined by the end of the month. As of the month-end, the yield of 10-year OFZs was 8.66% (-14 bp), whereas the spread between the 2-year and 10-year bonds remained virtually unchanged. The total amount of bonds sold by non-residents was bought by collective investors.

**Stocks.** The MOEX Index grew by 5.5% in ruble terms and by 9.1% in US dollar terms, having surpassed markedly most EMEs (Chart 9). The main contribution to the growth of Russian indices was made by oil producing companies, given increasing global oil prices. Prices were driven by purchases by local investors, as non-residents were net sellers in September by reducing their investment in Russian stocks by 11 billion rubles.

**Chart 8**

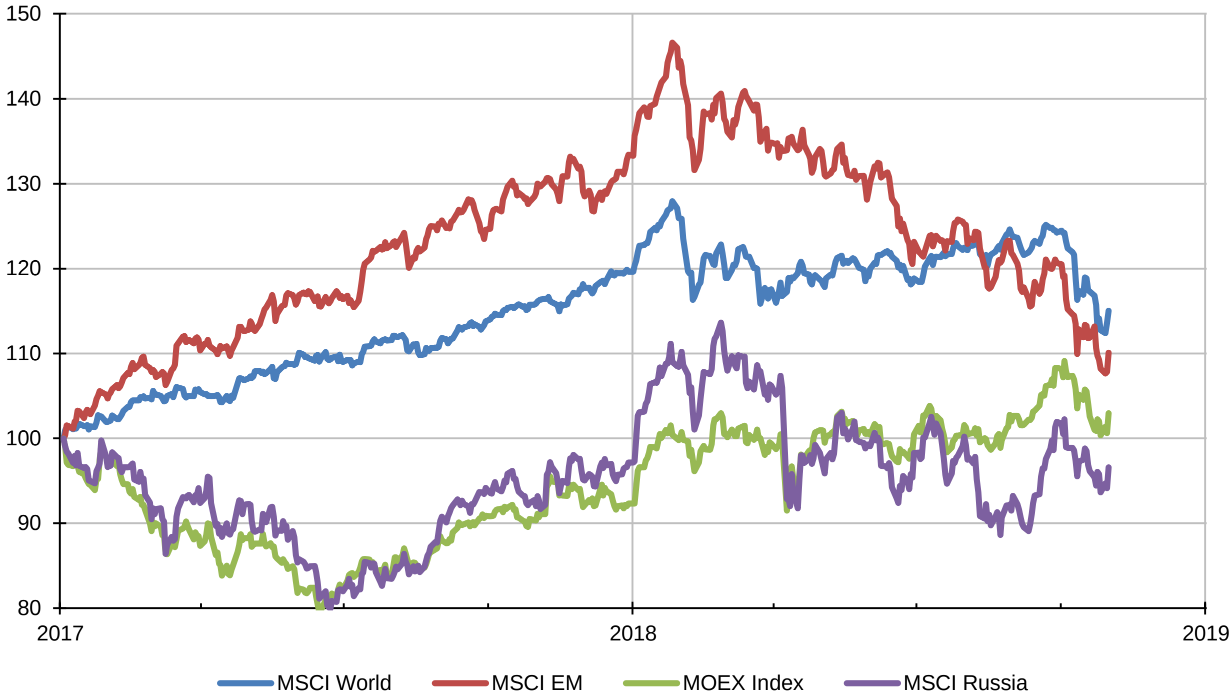
**In September, CDS spreads for most EMEs (including Russia) declined**




** The average CDS spread calculated based on CDS for China, Indonesia, Panama, Colombia, Chile, Peru, Mexico, Malaysia and the Philippines.*
*Sources: Bloomberg, Bank of Russia calculations.*

**Chart 9**

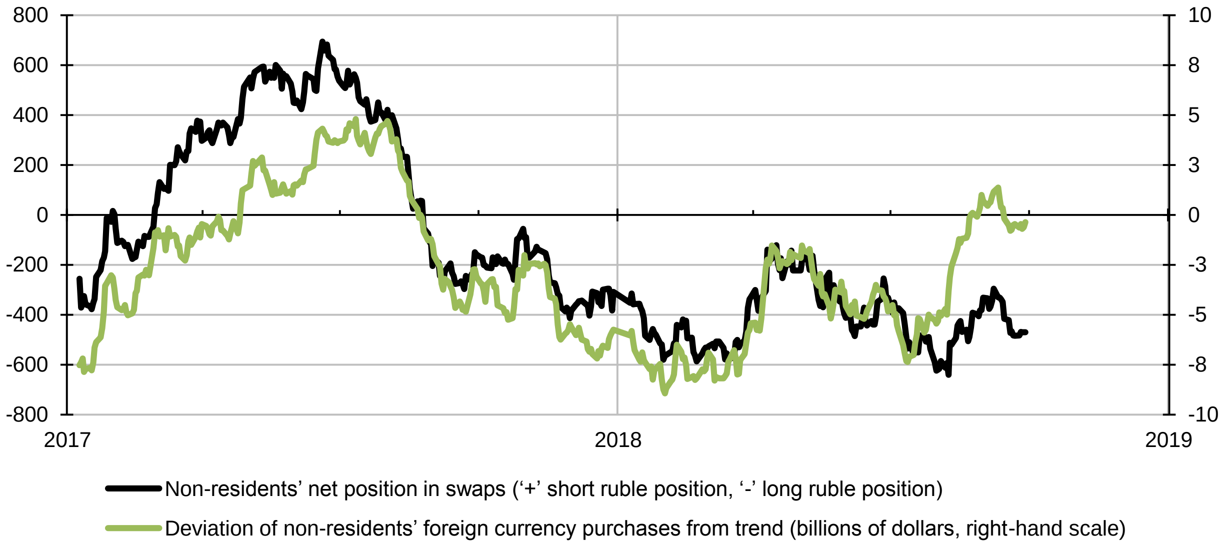
**Russian stock indices demonstrated a considerable growth in September**




*Sources: Bloomberg, Bank of Russia calculations.*

**Chart 10**

**Non-residents slightly increased their long ruble positions**

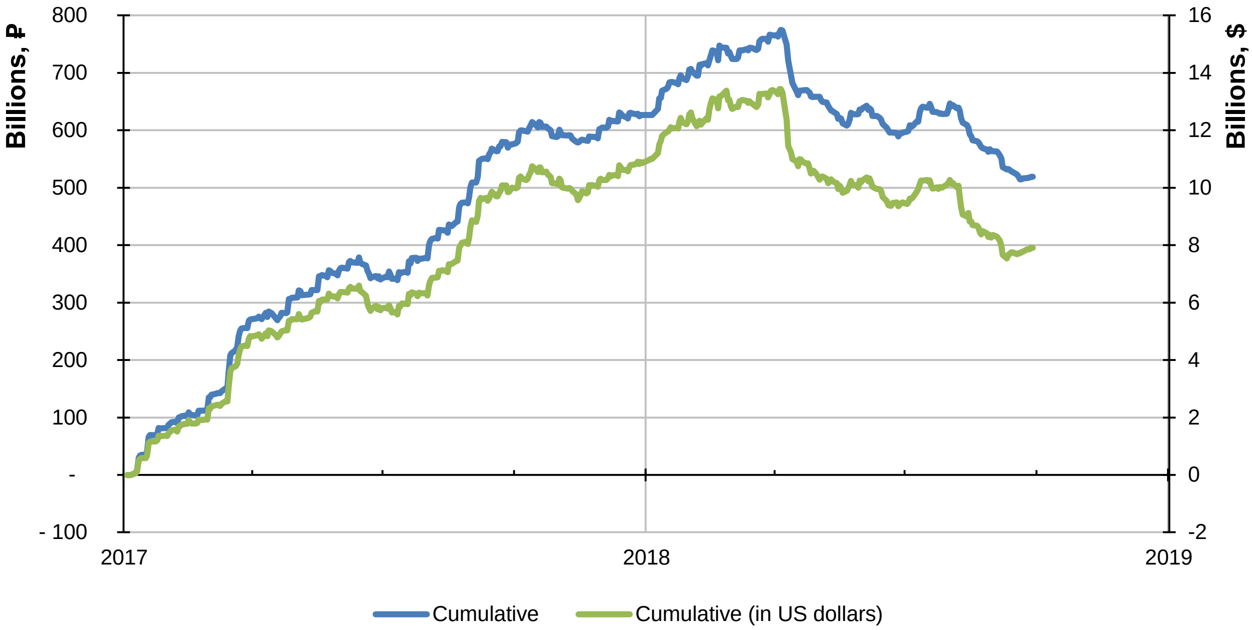



*Source: Bank of Russia calculations.*

Chart 11

**Non-residents continued to cut their investment in OFZs which made it possible for collective investors to expand their share**

**Foreign investors' net purchases in the OFZ market (according to exchange data)**




*Source: Bank of Russia calculations.*

Table 4

**Most segments of the Russian financial market saw price growth**

| Stock market indicators | | | | | |
|---|---|---|---|---|---|
| **Segment** | **Indicator** | **As of 28.09.2018 COB*** | **Change**** | | **Average 2017*** |
| | | | ***month*** | ***monthly average*** | |
| **Equity market** | MICEX index | *2,475.4* | 5.5 | 3.7 | *2,039.8* |
| | RTS index | *1,192.0* | 9.1 | 1.8 | *1,101.9* |
| **Bond market** | OFZ | *8.23* | -17.0 | 32.7 | *7.9* |
| | Corporate bonds | *8.75* | 1.0 | 43.2 | *8.9* |
| | Regional bonds | *8.56* | 5.0 | 51.4 | *8.5* |
| **Foreign market** | Russia-43 | *5.27* | -10.4 | 6.2 | *4.9* |
| | UST-10 | *3.06* | 20.1 | 10.4 | *2.3* |
| **Risk appetite indicators** | RVI | *23.9* | -0.8 | 0.8 | *21.3* |
| | EMBI+ Russia | *197.0* | -28.0 | -0.1 | *145.1* |
| | EMBI+ EM | *384.2* | -51.8 | 2.8 | *326.6* |
| | CDS | *143.3* | -24.3 | 5.7 | *156.0* |

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

*** In % for equity indices, points for RVI, and basis points (bp) for other indicators.*

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