



Bank of Russia

The Central Bank of the Russian Federation



No. 33

November 2018

Banking sector liquidity and financial markets

Facts, assessments and comments

Moscow

Cut-off date:

'Banking sector liquidity and money market'* section – 4 December 2018;

'Foreign exchange and stock market' section – 30 November 2018.

'Credit and deposit market' section – 1 November 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, the analysis of the effectiveness of the Bank of Russia's monetary policy operational procedure should take into required reserves account averaging periods. In November 2018, this is the period between 7 November 2018 and 4 December 2018.

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Banking sector liquidity and financial markets: facts, assessments and comments (November 2018)

- *In November, the structural liquidity surplus continued to decline as the Bank of Russia suspended fiscal rule-based foreign currency purchases in the domestic market.*
- *A small negative spread remained between interbank rates and the key rate as demand contracted in the market.*
- *FX liquidity continued to show favourable dynamics as a result of a massive inflow in the current account of the balance of payments and a suspension of fiscal rule-based foreign currency purchases.*
- *In November, the drop in global oil prices and rising geopolitical tensions dragged down prices in most segments of the Russian financial market. Having said that, the drop was less dramatic than could have been expected given the performance of the above factors.*
- *December is when Russian companies start to make their intermediate dividend payments. Their effect on the ruble exchange rate will be intangible.*
- *In October-November 2018, interest rates continued to increase in the deposit market, whereas rates in the credit market nearly stabilised. In this environment, the inflow of household funds to bank deposits resumed as banks' loan portfolio maintained an upward trend.*

Banking sector liquidity and money market

Ruble liquidity. In November, the structural liquidity surplus continued to decline as the Bank of Russia suspended fiscal rule-based foreign currency purchases in the domestic market. Liquidity outflow was partially offset by a decline in cash in circulation.

Money market. The spread between short-term rates in the interbank segment of the money market and the Bank of Russia key rate remained negative. However, the volatility of interest rates increased somewhat. Rates dropped against the key rate in mid-November, when certain banks temporarily expanded their supply in the overnight segment following, among other things, the repayments under long-term interbank transactions. The last week of the month saw the spread shrink following the outflow of ruble liquidity as bank customers paid taxes. In the middle of the averaging period, the banking sector accumulated liquidity overhang. It was associated with the fact that banks complied with reserve requirements in advance as one-week deposit auctions failed to attract enough liquidity from banks in the first half of the period. To absorb excess liquidity, the Bank of Russia held fine-tuning deposit auctions to underpin interest rates.

The September shift in the market structure prevented spread tightening. Certain banks increased their borrowings from the Bank of Russia and budget agencies, thus reducing their demand in

the market.¹ At the same time, other market participants have yet to adjust to the changes in the market structure and increase supply at Bank of Russia deposit auctions.

FX liquidity. Ruble rates on FX swaps held close to the interbank lending rates, suggesting that FX liquidity conditions in the banking sector were favourable. As before, this was helped by a high inflow to the current account of the balance of payments and the suspension of fiscal rule-based purchases of foreign currency throughout 2018. Operations of the Federal Treasury to place ruble liquidity through FX swaps, which were first held in November, failed to have a considerable effect on interest rates.

Compared with the forecast presented in the previous issue, **the assessment of the structural liquidity surplus as of year-end 2018** was revised upwards to 2.0-2.3 trillion rubles. The structural liquidity surplus as of year-end 2019 is now forecast at 2.2-2.8 trillion rubles (Table 1). This is associated with lower estimates of supplementary oil and gas revenue in 2018.

Volatility of autonomous liquidity factors is traditionally expected to rise in the last month of the year. This triggers both considerable fund inflows to and outflows from banks in certain periods.

¹ See information and analytical commentary 'Banking sector liquidity and financial markets', No. 31, September 2018.

Table 1

Structural liquidity surplus estimates were revised upwards against the forecast released in the previous issue

| (trillions of rubles) | November 2018 | January- November 2018 | 2018 (estimate) | 2019 (forecast) |
|---|---------------|------------------------------|---------------------|---------------------|
| 1. Liquidity factors (supply) | -0.2 | 0.4 | [0.0; 0.2] | [0.3; 0.6] |
| - changes in the balances of general government accounts with the Bank of Russia, and other operations* | -0.4 | -0.1 | [0.3; 0.4] | [1.0; 1.2] |
| - change in cash in circulation | 0.1 | -0.1 | [-0.8; -0.7] | [-0.7; -0.6] |
| - Bank of Russia interventions in the domestic FX market and monetary gold purchases** | 0.1 | 0.7 | 0.7 | 0.0 |
| - regulation of banks' required reserves with the Bank of Russia | 0.0 | -0.1 | -0.1 | 0.0 |
| 2. Change in free bank reserves (correspondent accounts) (demand) | -0.1 | 0.1 | [0.3; 0.4] | 0.1 |
| 3. Change in banks' claims on deposits with the Bank of Russia and coupon OBRs | -0.2 | 0.6 | [-0.5; -0.1] | [0.2; 0.5] |
| 4. Change in outstanding amounts on Bank of Russia refinancing operations (4 = 2 + 3 - 1) | -0.1 | 0.3 | [0.0; 0.1] | 0.0 |
| Structural liquidity deficit (+) / surplus (-) (as of the period-end) | -2.7 | | [-2.3; -2.0] | [-2.8; -2.2] |

* 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.

Sources of budget expenditure financing remain uncertain. Growth in tax revenues coupled with moderate expenses resulted in higher budget fund balances with the Bank of Russia and credit institutions (Chart 6). The Federal Treasury and budgets of Russian constituents are expected to keep high amount of cash on bank deposits and to use balances with the Bank of Russia (including funds received after conversion of NWF funds and attracted in the domestic market) to finance their expenses. This will ensure liquidity inflow to the banking sector through the fiscal channel.

In November, cash in circulation gradually approached last year readings. Considerable growth registered in Q2-Q3 was offset by the return of cash funds to banks in October and November. In December, this factor is expected to trigger a seasonal liquidity outflow from the banking sector in the run-up to New Year holidays.

Overall dynamics of cash in circulation are in line with changing economic growth rates and retail trade turnover. That said, the development and spread of cashless payments contain growth in cash in circulation to a certain extent. Since 2017 H2, card payments for goods and services have exceeded and increased considerably faster than inflow of cash funds from sales of goods and services to banks. Furthermore, cash withdrawal through ATMs has been declining. In January-October 2018, the inflow of rubles after the purchase of cash foreign currency by households less outflow of rubles following foreign currency sales to households² failed to exceed the amount of similar operations in the respective periods of 2016 and 2017. However, the outflow of cash funds following retail deposit transactions increased due to a lower inflow of funds to bank accounts. This is associated with the fact that wages are increasingly paid in cashless form. Therefore, deposits are also replenished by transferring funds from current to term deposit accounts.

Table 2

Expected interest rate path based on market instruments remained practically unchanged

| 1. Expectations based on market indicators* interest rate (instrument) | January 2019 | April 2019 | July 2019 |
|---|---------------------|---------------------|---------------------|
| - MosPrime 3M (FRA) | 8.56 (8.56) | 9.02 (8.73) | 9.35 (9.08) |
| - RUONIA (ROISfix) | 7.59 (7.58) | 7.88 (7.93) | 8.47 (8.55) |
| - RUONIA (futures) | 7.68 (7.70) | 7.95 (8.04) | 8.26 (8.45) |
| 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 (7.5) | 7.75 (7.5) | 7.5 (7.5) |
| - Reuters survey | 7.5 (7.5) | 7.75 (7.5) | 7.75 (7.5) |
| 3. Implied inflation rate (OFZ-IN) (until 16 August 2023) | | 5.13 (5.27) | |

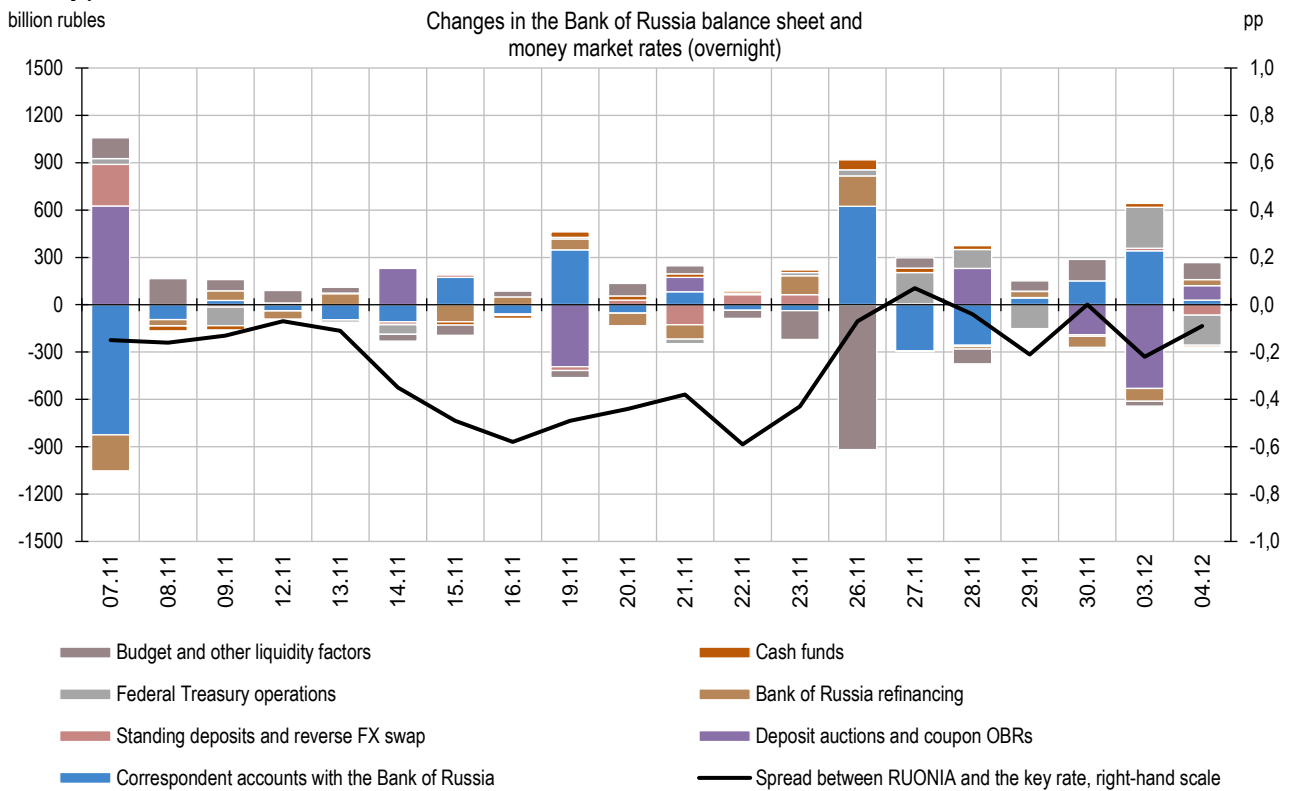
* Data as of the end of previous month are given in brackets.

Source: Bank of Russia calculations

² According to Reporting Form 0409202.

Chart 1

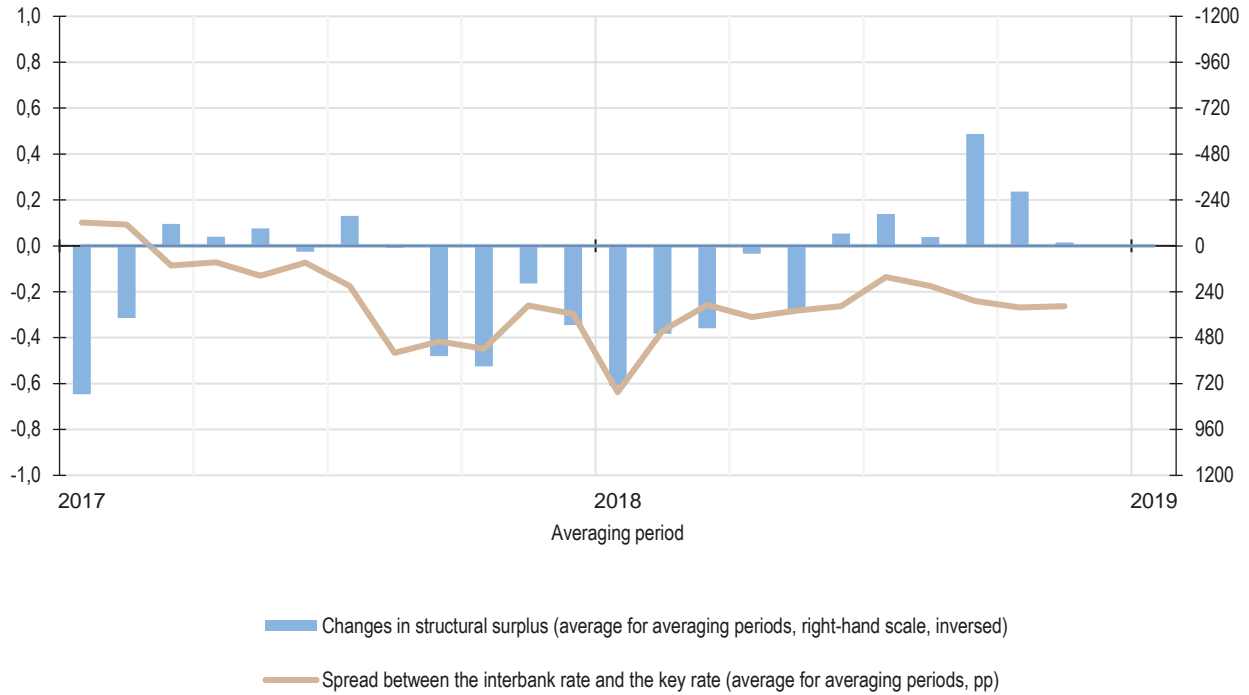
November 2018 saw an outflow of funds from banks through the budget channel as the Bank of Russia suspended fiscal rule-based foreign currency purchases in the domestic market



Source: Bank of Russia calculations.

Chart 2

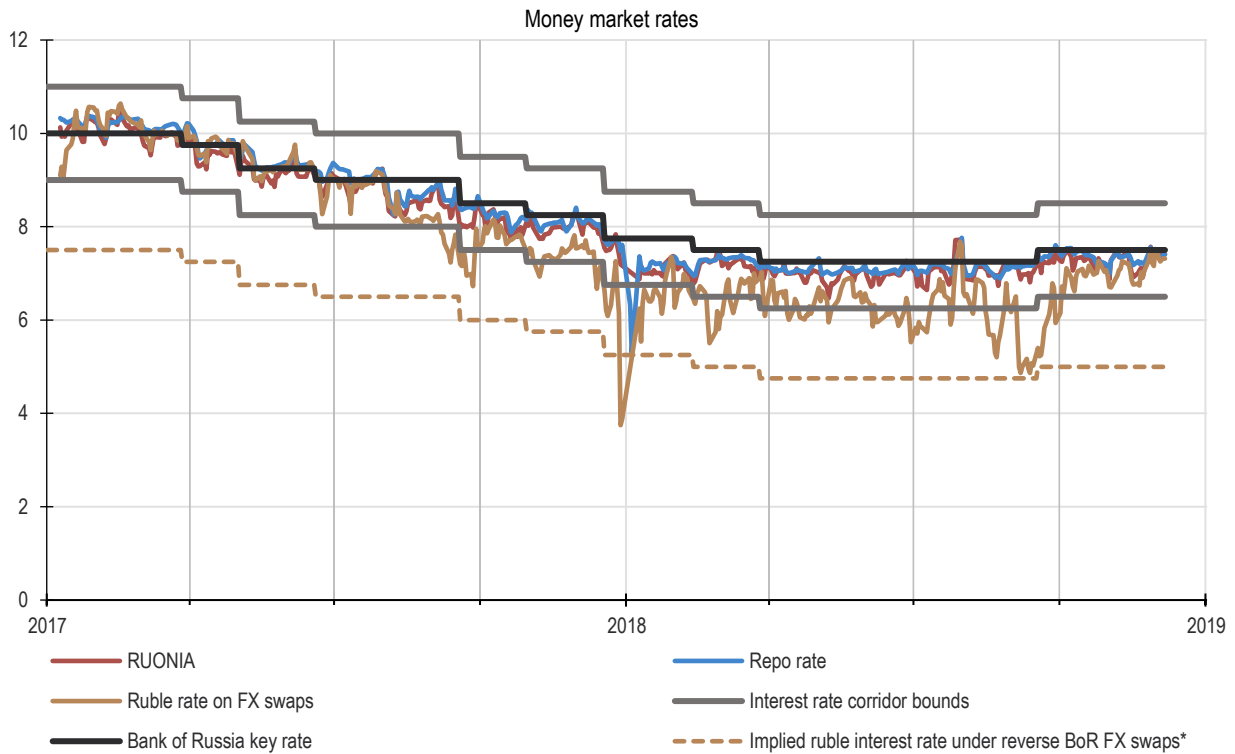
Spread between interbank rates and the key rate changed insignificantly in the November averaging period



Source: Bank of Russia calculations.

Chart 3

A small negative spread remained between interbank rates and the Bank of Russia key rate

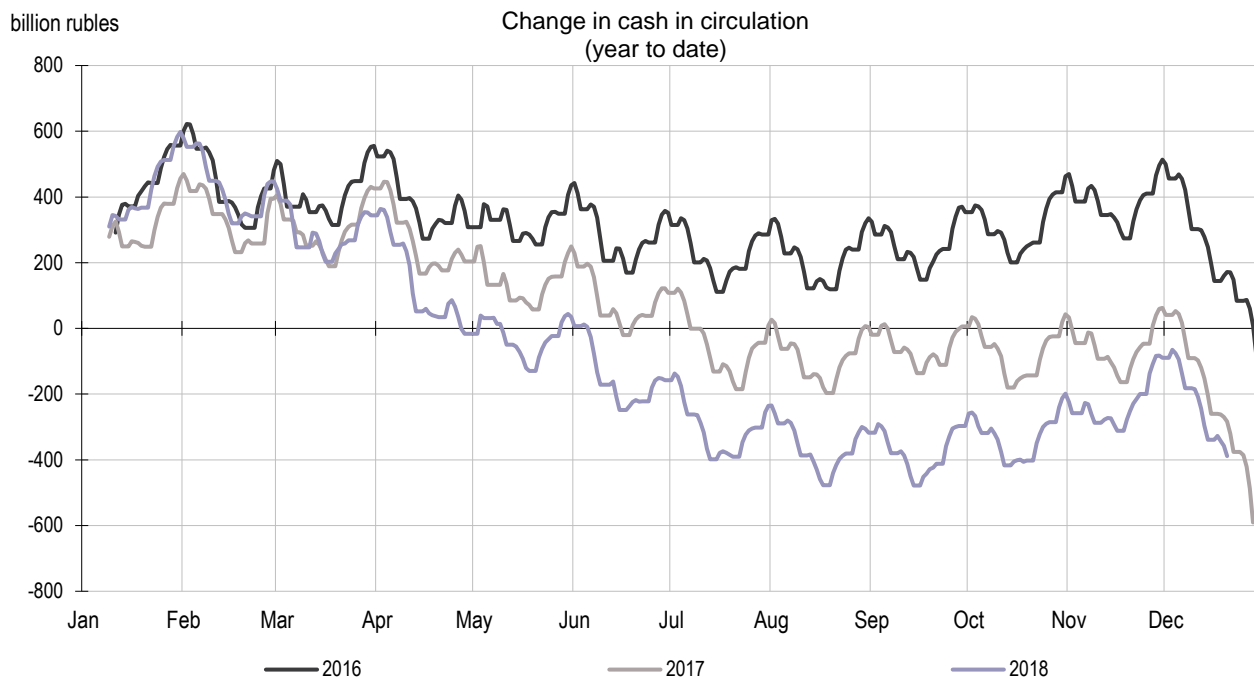


* Implied rate = ruble lending rate - FX borrowing rate + LIBOR
 (from 19.12.2016: key rate - 1 pp - (LIBOR + 1,5 pp) + LIBOR = key rate - 2,5 pp)

Source: Bank of Russia calculations.

Chart 4

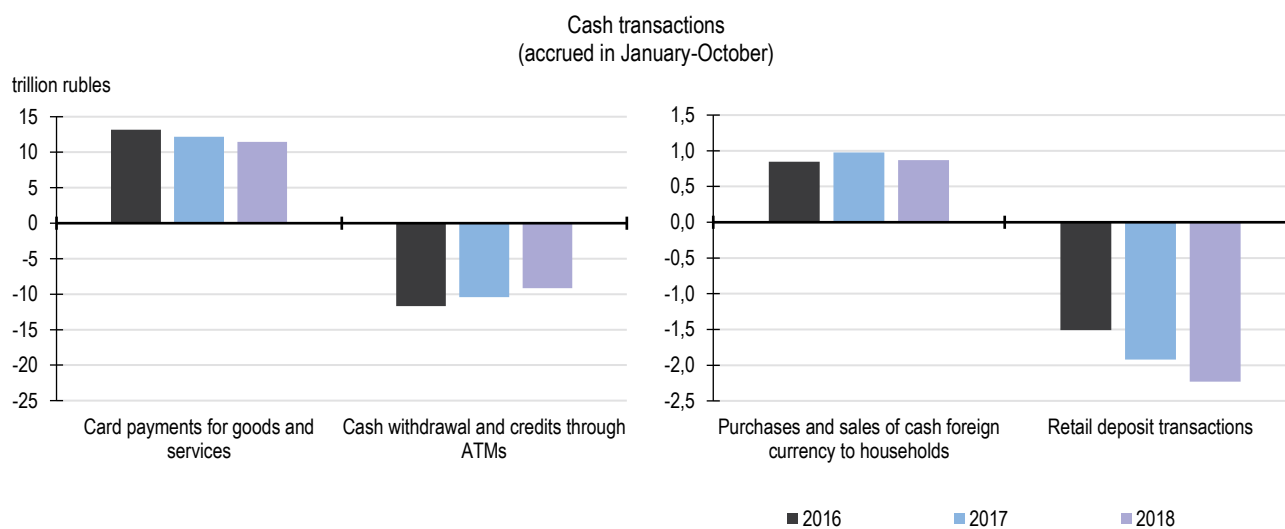
Cash in circulation gradually approached last year readings: the inflow of cash funds to banks in the October-November period offset their outflow in Q2-Q3



Source: Bank of Russia calculations.

Chart 5

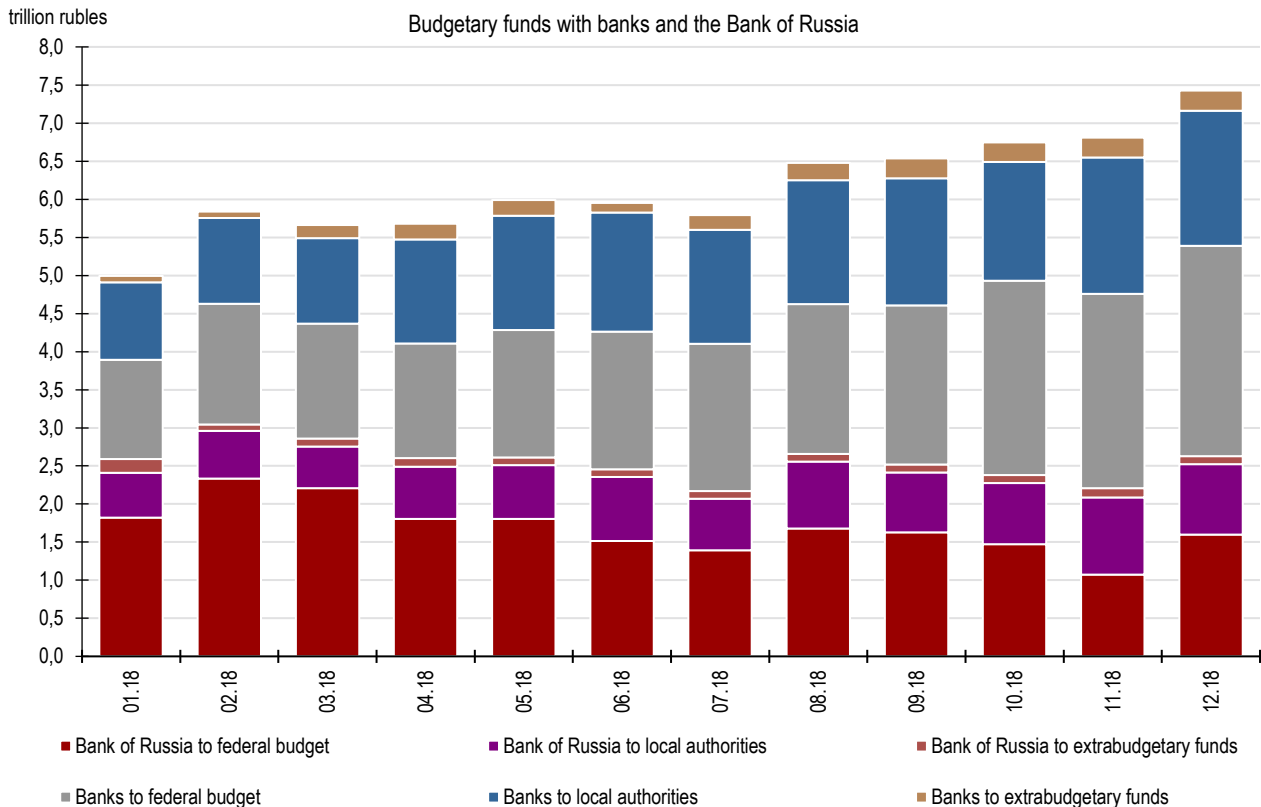
The development and spread of cashless payments contain growth in cash in circulation to a certain extent



Source: Bank of Russia calculations using Form 0409202.

Chart 6

Increased tax revenues coupled with moderate expenses resulted in higher budget fund balances with the Bank of Russia and credit institutions



Source: Bank of Russia calculations.

Table 3

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

| (start of business, trillions of rubles) | 01.12.2018 | 01.11.2018 | 01.01.2018 |
|--|-------------|-------------|-------------|
| Structural liquidity deficit (+) / surplus (-) | -2.7 | -2.9 | -2.6 |
| Bank of Russia standard monetary policy instruments | | | |
| Bank of Russia claims on credit institutions | 0.4 | 0.4 | 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 | 0.4 | 0.0 |
| - repos and FX swaps | 0.0 | 0.0 | 0.0 |
| - secured loans | 0.3 | 0.4 | 0.0 |
| Credit institutions' claims on the Bank of Russia | 3.3 | 3.6 | 2.7 |
| • Deposits | 1.7 | 2.1 | 2.4 |
| - auction-based | 1.5 | 2.0 | 2.1 |
| - fixed interest rate | 0.2 | 0.2 | 0.2 |
| • Bank of Russia bonds | 1.6 | 1.5 | 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 |

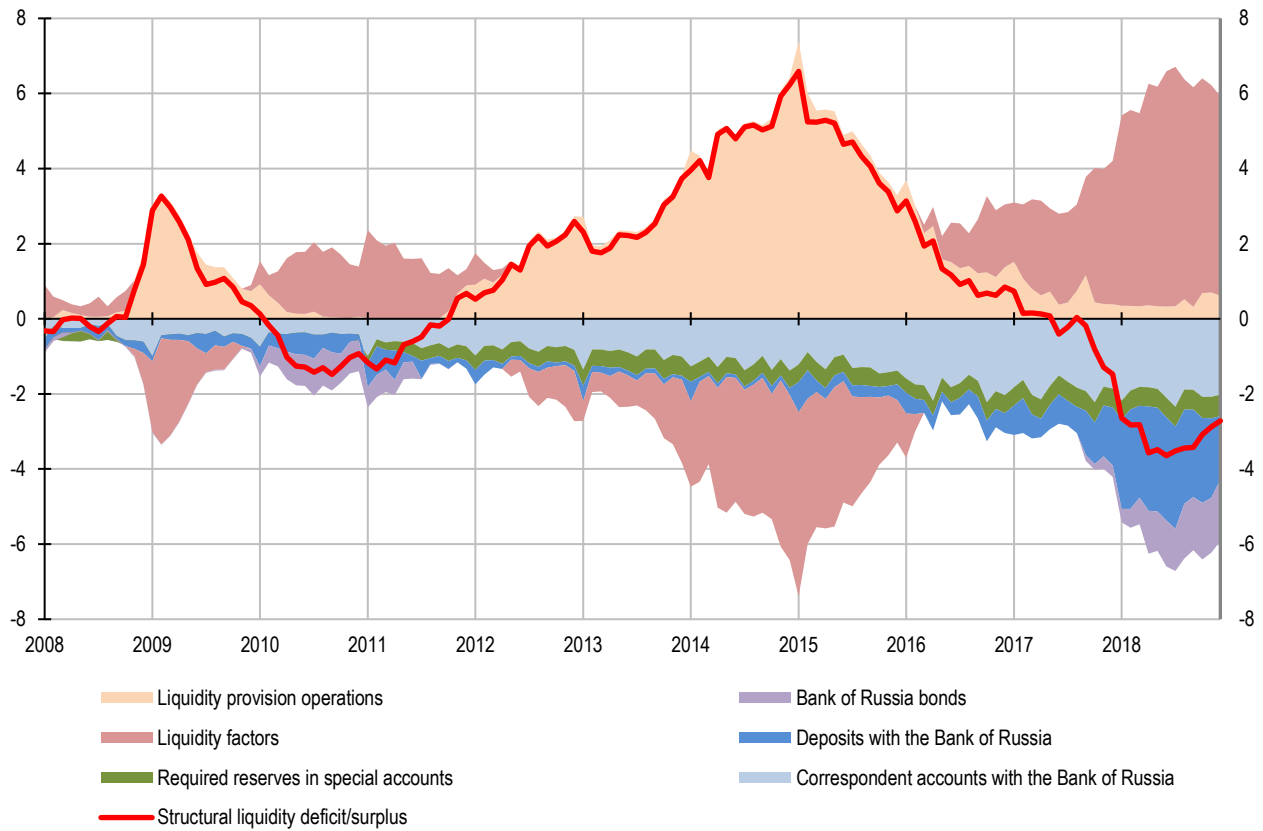
* These transactions include Bank of Russia specialised refinancing instruments, Bank of Russia loans issued under irrevocable credit lines, and USD/RUB and EUR/RUB sell/buy FX swaps.

Source: Bank of Russia calculations.

Chart 7

trillion rubles

Bank of Russia balance sheet



Source: Bank of Russia calculations.

Foreign exchange and stock market

In November, the drop in global oil prices and rising geopolitical tensions dragged down prices in most segments of the Russian financial market. Having said that, the drop was less dramatic than could have been expected given the dynamics of the above factors.

Foreign exchange rate. In November, the EMCI that reflects performance of emerging market (EM) currencies grew by 1.6%. This was partially associated with a rising risk appetite amid a softer narrative by the US Fed regarding the future tightening of its monetary policy. At the same time, currencies of oil exporting countries largely depreciated on the back of a 20% drop in oil prices. Against this backdrop, the ruble also weakened; however, the depreciation was insignificant (1.9%), especially given the rising geopolitical tensions.

Country risk premium. Rising geopolitical tensions had a somewhat stronger effect on Russia's CDS spread than in other countries. In November, it grew by 19 bp, whereas in other EMs average growth came in at 5 bp. However, this effect proved short-lived, and as early as the first half of December the premium returned to the early November level, whereas most other EMs failed to demonstrate a decline in CDS.

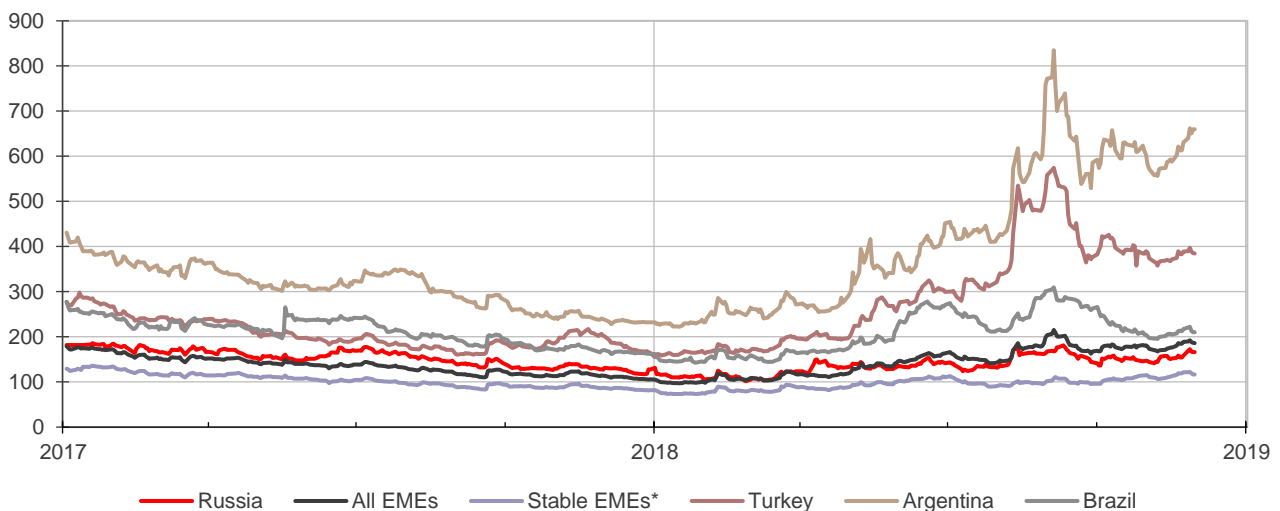
OFZ. For the same reason OFZs lost their attractiveness for foreign investors, which began to recover in October. Despite the fact that non-residents still participated in the auctions of Russia's Ministry of Finance, their large sales in the secondary market reduced their investments by 15 billion rubles (according to the exchange data). In this environment, yields of short-term issues rose by 20 bp. Overall, foreign investment has remained at approximately the same level since mid-September (Chart 12).

Stocks. The stock market performed similarly to the FX market. The MSCI EM index, which reflects dollar cost of EM shares, rose by 4% suggesting that demand for risk assets was recovering. At the same time, stock indices of most oil exporting countries were in decline. The MSCI Russia index dropped by 1.2% over the period under review.

December is when Russian companies start to make their intermediate dividend payments. According to the Bank of Russia estimates based on Bloomberg data as of 10 December 2018, payments to be made in December 2018 – January 2019 will total approx. 366 billion rubles, roughly 20% more than during the same period of the previous year. Given the relatively low payments, their conversion into foreign currency by foreign shareholders will not have a considerable effect of the ruble exchange rate.

Chart 8

Russia's CDS spread showed a larger increase than other EMs due to rising geopolitical tensions

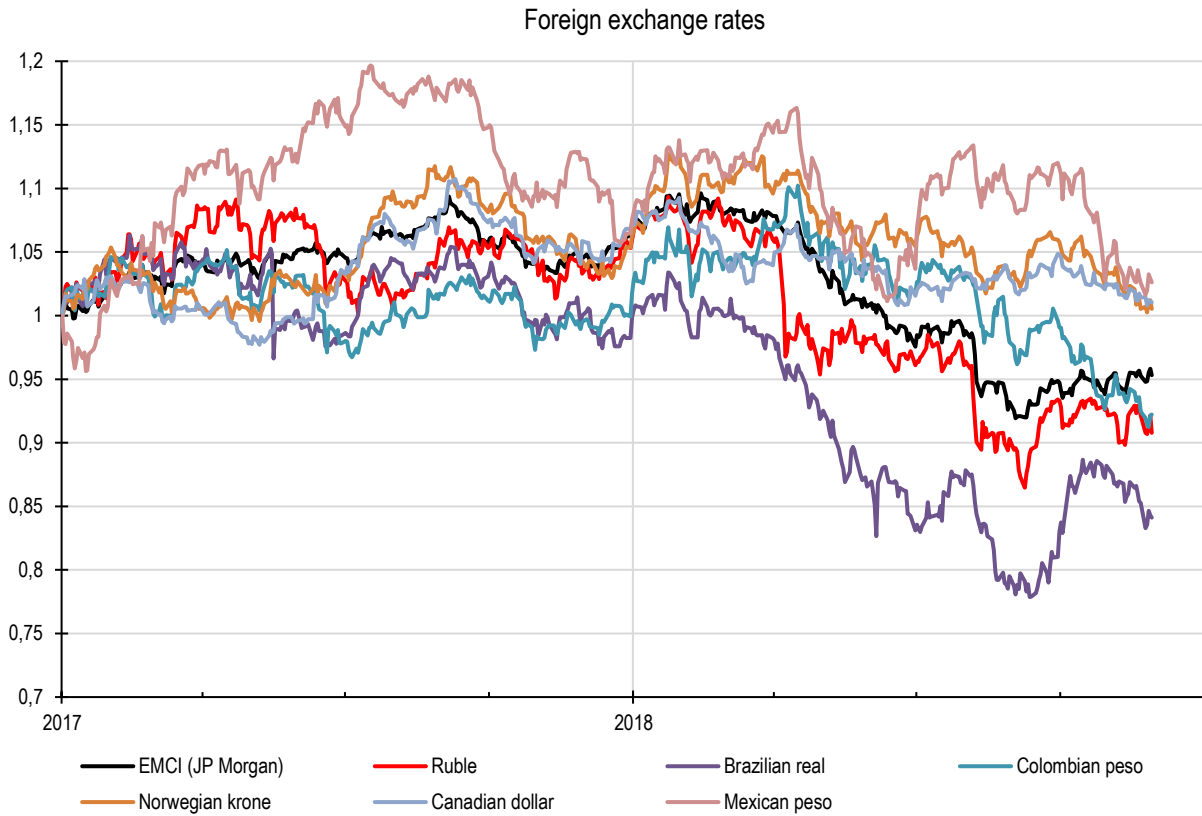


* The average CDS spread calculated based on CDS for China, Indonesia, Panama, Colombia, Chile, Peru, Mexico, Malaysia and the Philippines.

Source: Bloomberg, Bank of Russia calculations.

Chart 9

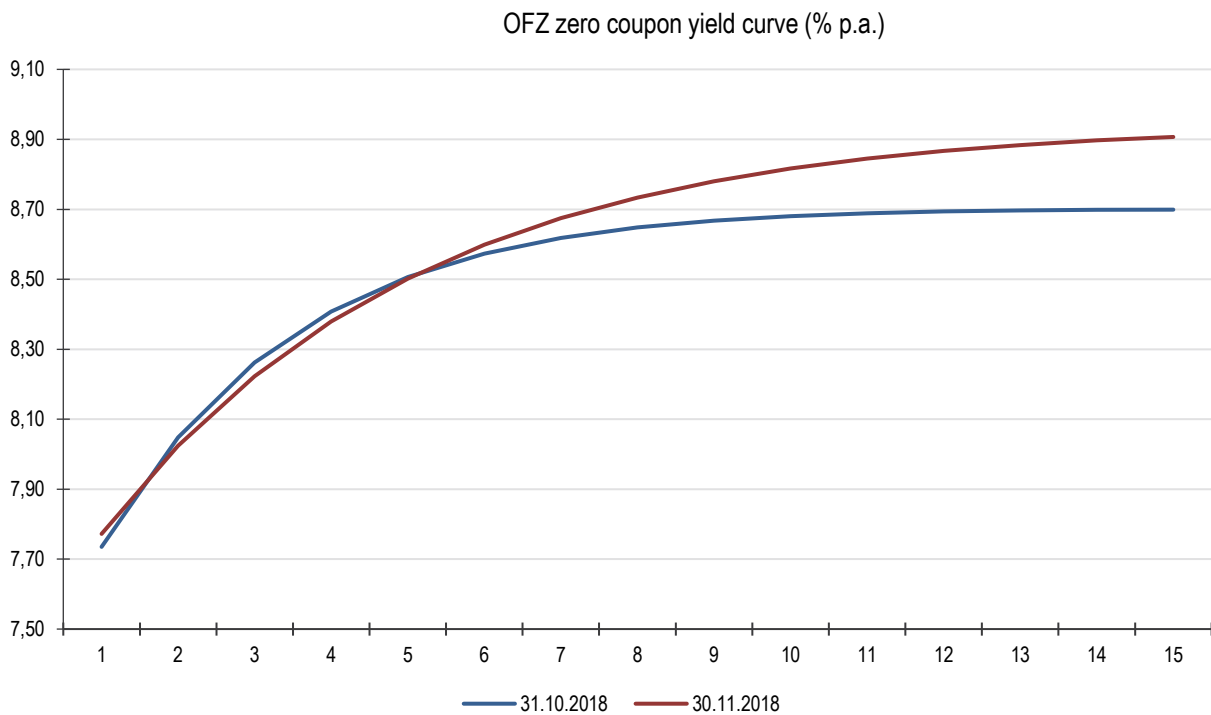
Currencies of oil exporting countries largely depreciated



Sources: Bloomberg, Bank of Russia calculations.

Chart 10

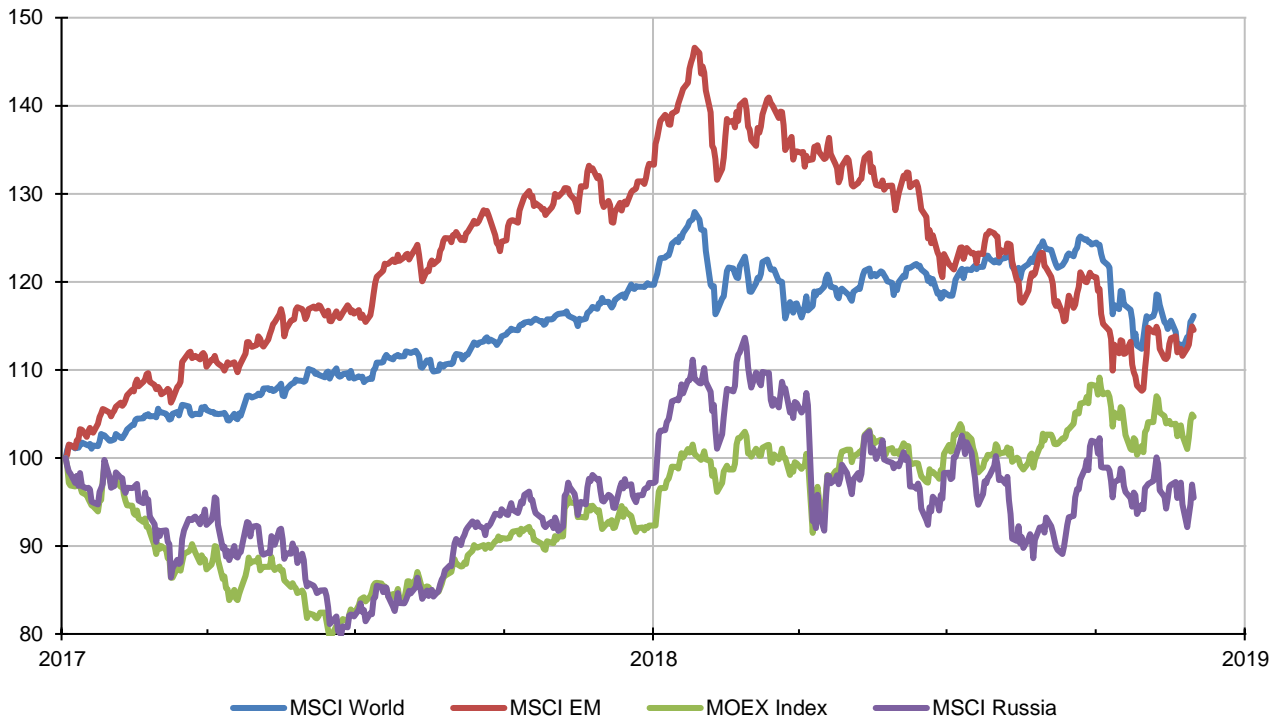
Yields of long-term OFZs increased due to sales by non-residents



Source: Bloomberg, Bank of Russia calculations.

Chart 11

The MSCI Russia index dropped on the back of falling oil prices

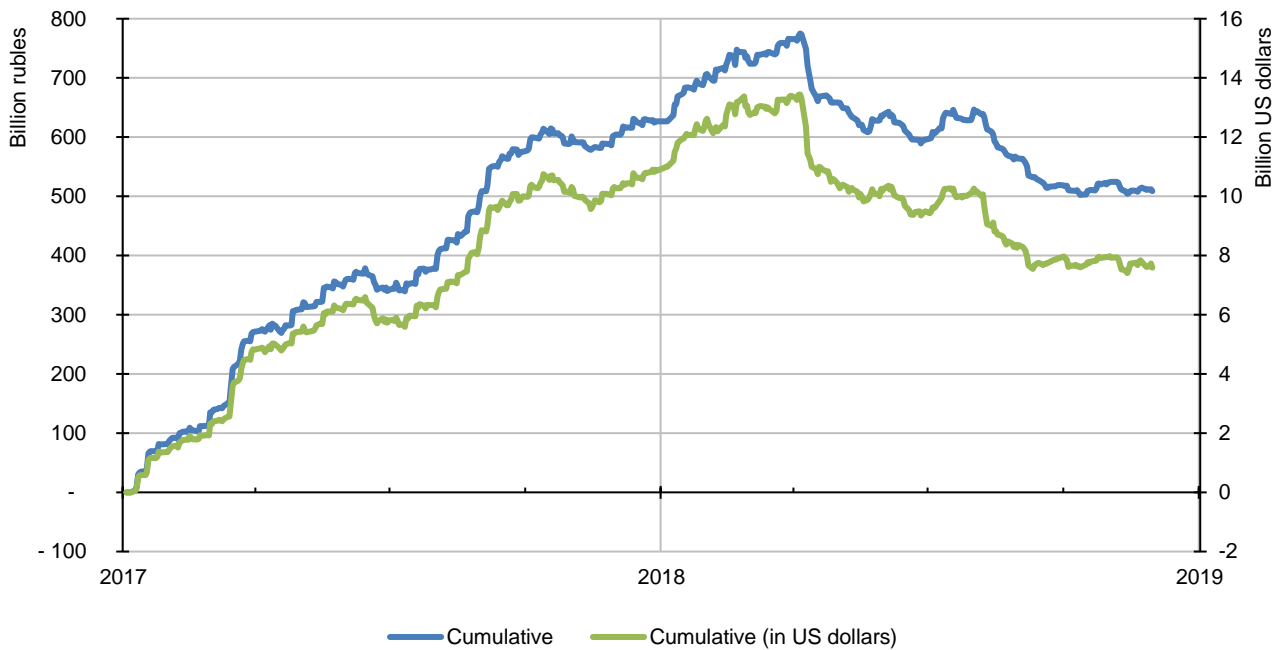


Source: Bloomberg, Bank of Russia calculations.

Chart 12

Non-residents were OFZ net sellers

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 did not see any significant price change

| Stock market indicators | | | | | |
|--------------------------|-----------------|--------------------------------|----------|-----------------|------------------|
| Segment | Indicator | As of 30 November 2018 COB* | Change** | | Average 2017* |
| | | | month | monthly average | |
| Equity market | MICEX index | 2392.5 | 1.7 | -0.4 | 2039.8 |
| | RTS index | 1126.1 | 0.0 | -1.4 | 1101.9 |
| Bond market | OFZ | 8.44 | 3.0 | 11.7 | 7.9 |
| | Corporate bonds | 8.98 | 14.0 | 15.1 | 8.9 |
| | Regional bonds | 8.69 | 21.0 | 9.1 | 8.5 |
| Foreign market | Russia-43 | 5.59 | 9.5 | 14.6 | 4.9 |
| | UST-10 | 2.99 | -15.5 | -4.5 | 2.3 |
| Risk appetite indicators | RVI | 26.6 | -1.0 | -1.3 | 21.3 |
| | EMBI+ Russia | 229.0 | 23.0 | 17.6 | 145.1 |
| | EMBI+ EM | 429.2 | 21.3 | 17.2 | 326.6 |
| | CDS | 166.4 | 19.0 | 6.6 | 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.

Credit and deposit market

In October 2018, **the deposit market saw an ongoing interest rate increase, whereas lending rates held close to their September readings** (Chart 13). Preliminary data suggest that deposit rates continued to grow in November, whereas rates on standard credit products failed to demonstrate significant changes. This heterogeneity of interest rate movements may be associated both with different pace of the pass-through of money and stock market conditions to rates on bank operations (rates on corporate and short-term retail loans quickly responded to changes in stock and money market conditions and increased faster than deposit rates in the August-September period), and competition between banks that contains lending rate growth but forces deposit rate hikes. Competition in the deposit market could be boosted by the outflow of funds from household deposits seen in the August-September period that faded in October.

Deposit market. In October 2018, growth of household bank deposits resumed. The inflow of funds came exclusively from growing ruble deposits; the FX segment of the market saw an ongoing deposit shrinkage. Amid an insignificant nominal weakening in the ruble as of the month-end, this reduced the share of retail FX deposits further. October did not register any trends towards a decline in bank deposit maturity which prevailed in recent years (Chart 14). Long-term operations accounted for 80% of growth in household ruble deposits in October. This performance of deposits may be explained by an outpacing increase of interest rates on long-term deposits (for more than 1 year) that makes them more appealing to depositors.

Credit market. Bank lending expanded further in October as lending rates remained relatively stable. Lending growth pace declined somewhat in both retail and corporate segments compared with September readings; however, it still exceeded the figures registered in October 2017. Lending continued to

grow in annual terms in key market segments (Chart 15).

The quality of corporate loan portfolio remained stable in October, while the quality of retail loan portfolio continued to improve (Chart 15). This favoured further development of the growth trend in consumer lending which emerged in the third quarter. As of the end of October, growth in consumer loan portfolio exceeded that in mortgage lending by a factor of 1.5. Growth in consumer lending represents, to a certain extent, a recovery in this segment. Unlike mortgage lending that posted sustainable growth during the recent years, consumer lending contracted significantly in 2015-2017 and only posted positive annual growth readings in the middle of last year (Chart 16). The fading of recovery coupled with the Bank of Russia's measures aimed at containing excessive growth of unsecured consumer lending will gradually slow growth in this market segment. However, the market share of consumer lending may grow further in the short run.

The corporate segment of the lending market also saw structural shifts. Like in the previous months, lending to the chemical and food industries and agriculture made a considerable contribution to market growth. However, October also saw a sizeable increase in lending to trade companies; this may suggest both gradual revival of consumption, and banks' willingness to expand their lending coverage.

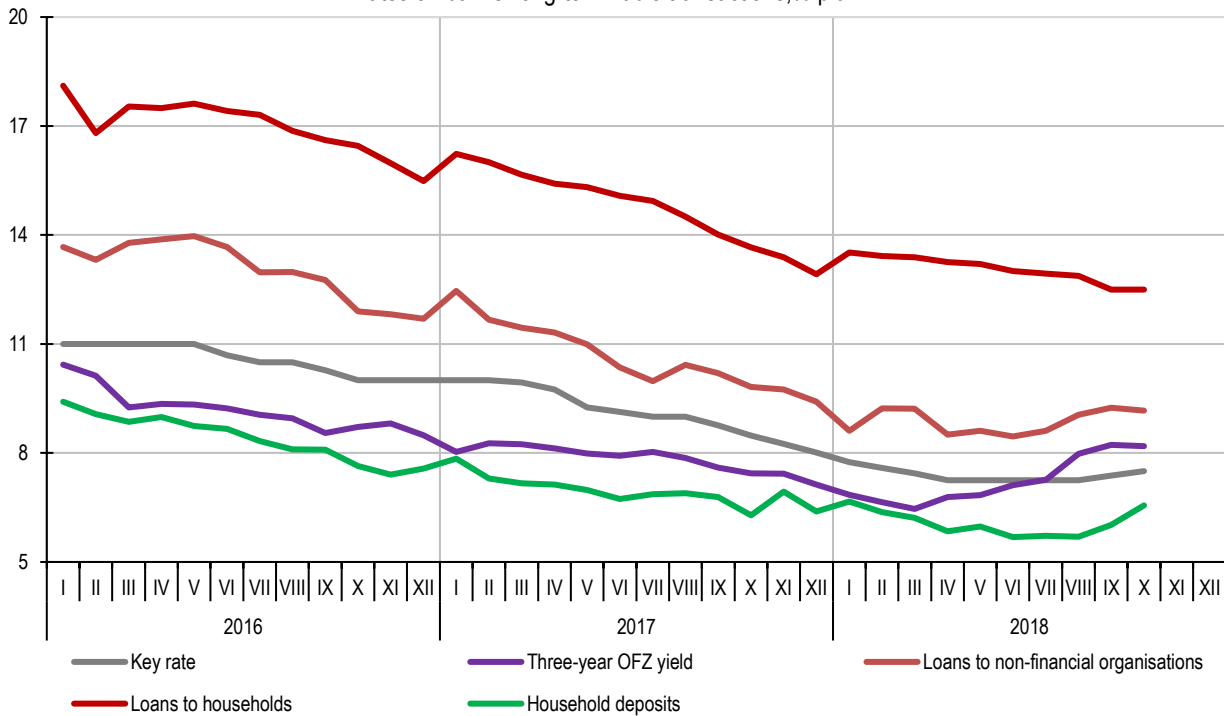
According to preliminary data, the credit market continued to grow in November with outpacing expansion registered in retail lending.

Banks' financial performance. The improvement in the quality of banks' loan portfolio coupled with ongoing growth of bank assets boosted bank profits. In October, profit of the Russian banking sector exceeded 110 billion rubles; preliminary data suggest that November posted considerable profits. Further growth of profit-driven banks' capital will increase banks' operations and expand the range of potential borrowers.

Chart 13

Deposit rates continued to grow in October amid relatively stable lending rates

Rates on banks' long-term ruble transactions, % p.a.

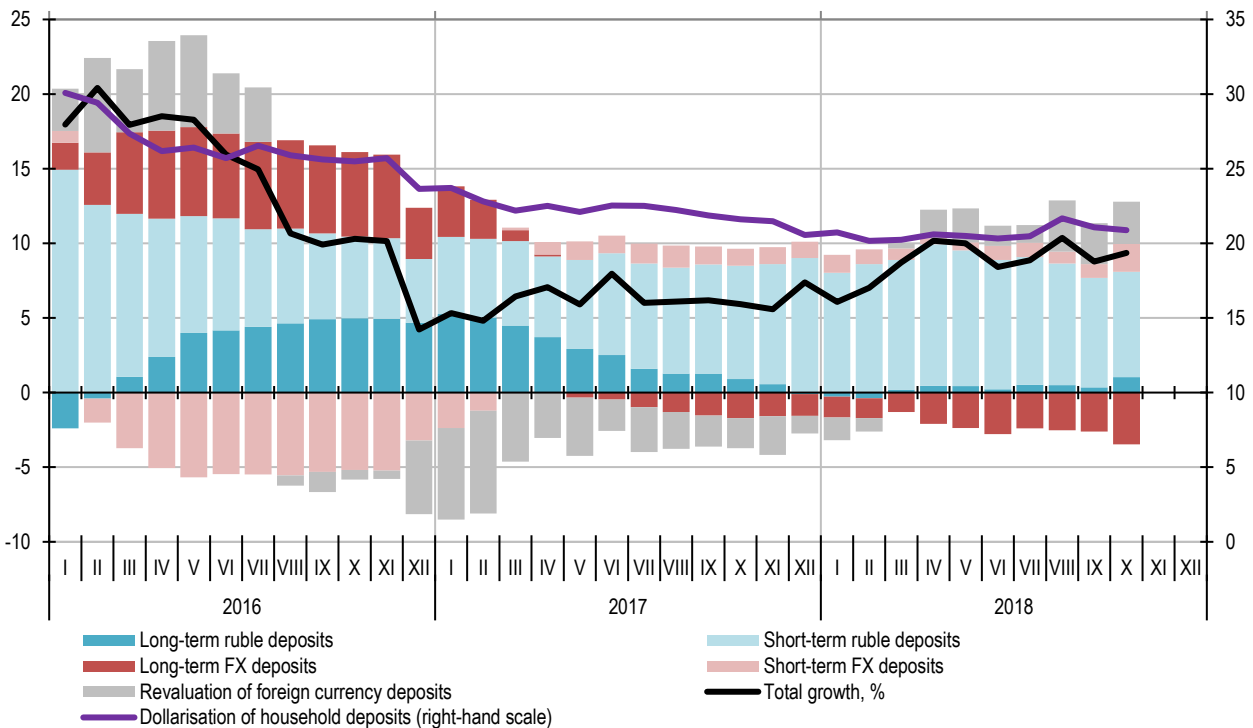


Source: Bank of Russia calculations.

Chart 14

Depositors continued to replace FX deposits with ruble-denominated ones

Contribution of individual elements to annual growth of household deposits, pp



Source: Bank of Russia calculations

Chart 15

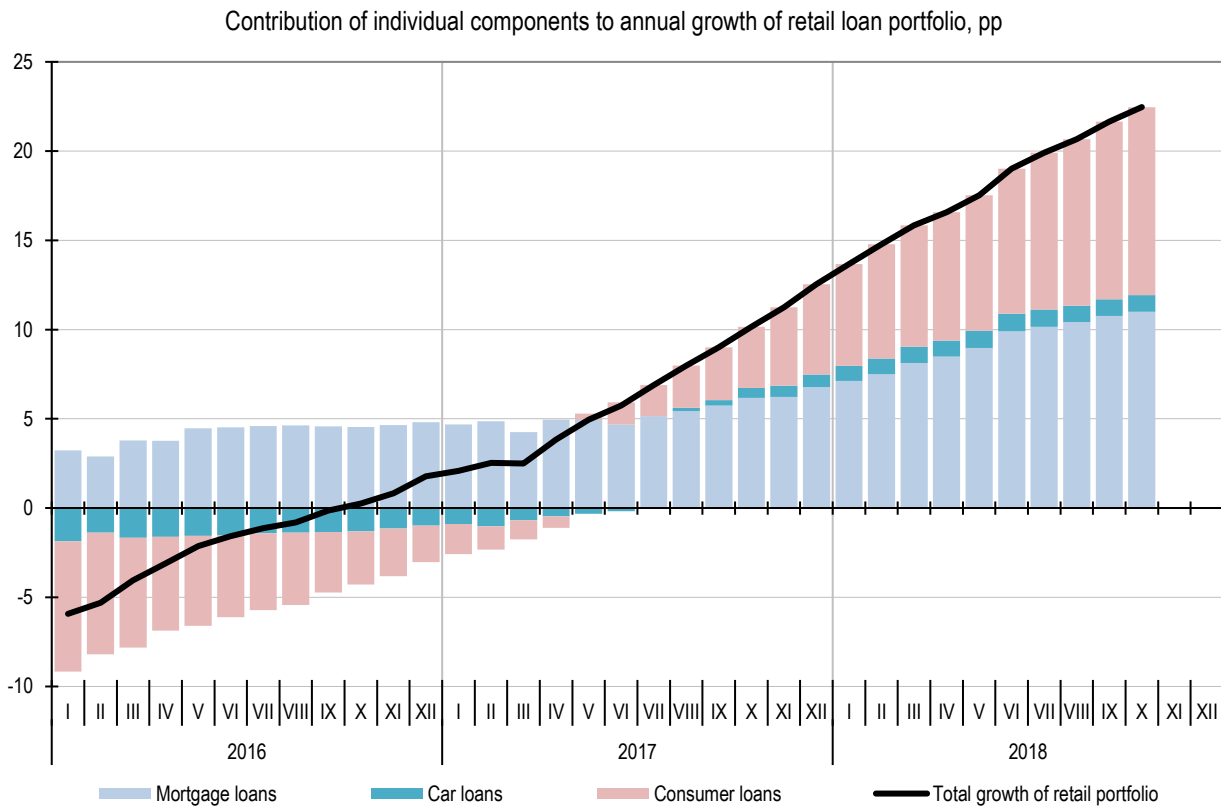
Retail segment of the credit market continued to grow at an outpacing rate as the quality of retail loan portfolio improved



Source: Bank of Russia calculations.

Chart 16

In the last months of 2018, the contribution of consumer lending to retail lending growth exceeded that of mortgage

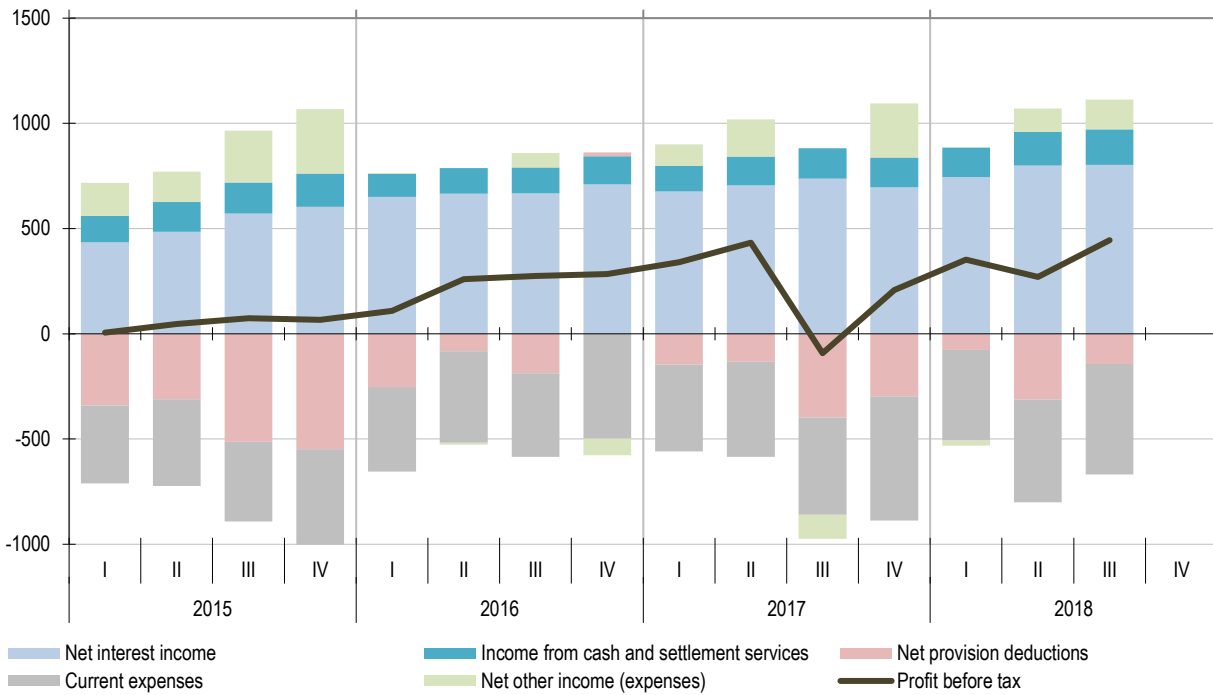


Source: Bank of Russia calculations.

Chart 17

Due to lower loss provision deductions, the financial result of the Russian banking sector was close to historic highs

Financial performance of Russian banks (billions of rubles)

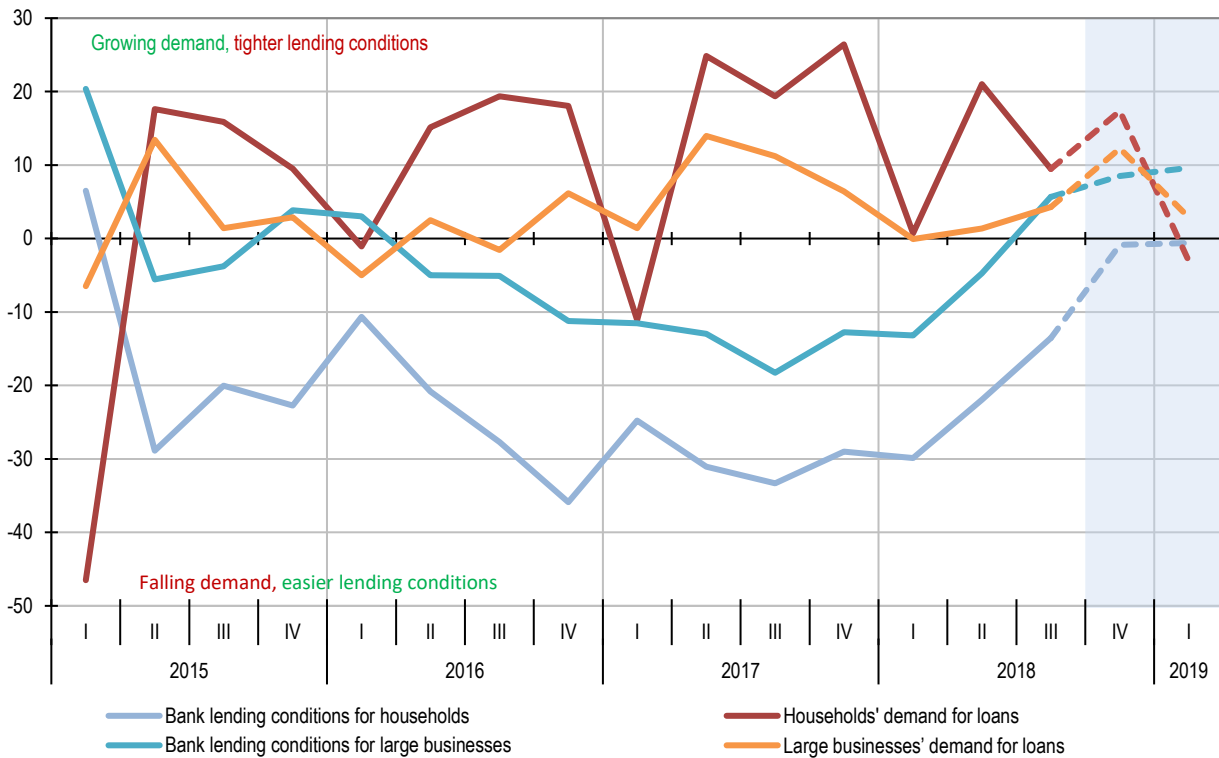


Source: Bank of Russia calculations.

Chart 18

Demand for loans continued to rise in 2018

Lending conditions and demand for loans indices, pp



Source: Bank of Russia calculations.