



Bank of Russia



BANKING SECTOR LIQUIDITY AND FINANCIAL MARKETS

No. 10 (56) • October 2020

Information and analytical commentary

12 November 2020

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

- In October, the surplus of structural liquidity shrank due to the outflow of funds which resulted from budget operations related to the extensive borrowing by Russia's Ministry of Finance.
- The spread between interbank lending (IBL) rates and the Bank of Russia key rate contracted following the decrease in the surplus. Short-term imbalances in liquidity distribution were partially offset owing to the inflow of funds under the Federal Treasury's operations and the Bank of Russia's repos.
- The interest rate spread in the FX swap and IBL segments expanded as non-residents built up long FX swap positions and individual banks reduced their supply of foreign currency liquidity, with its cost slightly rising in global markets.
- Early October was relatively positive for global financial markets. Markets were growing in the majority of countries amid investors' expectations regarding the outcome of the US presidential election. However, the surge in coronavirus cases and the reintroduction of lockdowns in the second half of the month provoked a new decline in markets.
- In September, the reduction in deposit rates discontinued as the key rate was not revised and the yields of federal government bonds (OFZ) increased. The annual growth of retail deposits, predominantly short-term ones, remained moderate.
- In August, average interest rates on corporate loans continued to go down, including because of preferential lending. Interest rates in retail lending changed diversely in September, with the mortgage rate rising, including due to the increased market share of the secondary segment, and interest rates on long-term non-mortgage loans falling.
- Retail lending continued its recovery growth in September, primarily owing to record-high activity in the mortgage market. Corporate lending maintained a stable upward trend.

Banking sector liquidity and money market

Ruble liquidity. On average, the structural liquidity surplus in the October required reserve averaging period shrank by 0.8 trillion rubles against the September averaging period, to 1.0 trillion rubles. Its amount as of early November decreased by 0.7 trillion rubles compared to the beginning of the previous month, to total 0.7 trillion rubles (Table 2).

Operations in the budget system's accounts were the key factor of the liquidity outflow in October. As economic activity bounced back in the previous months, payments of the main non-oil and gas taxes (VAT, profit tax, personal income tax) to the budget increased to pre-pandemic levels (Chart 2). Another reason for the liquidity reduction in the banking sector was public companies' dividend payments rescheduled from summer to October,

particularly record-high dividends paid out by Sberbank. Furthermore, Russia's Ministry of Finance continued to expand its OFZ offerings in the domestic market.

The outflow of liquidity caused by the above factors was offset only partially by the inflow of funds to the banking sector as budget expenditures and operations with temporarily available budgetary funds. Expenditures in October slightly increased in annualised terms, while staying lower than during the peak months of 2020. The Federal Treasury (FT) sought to promptly place funds from OFZ offerings and revenues with the banking sector, including through out-of-schedule bid selections. Nonetheless, it was unable to place the entire amount of received revenues and borrowings by the end of the month, due to which the balance in the federal budget accounts with the Bank of Russia increased significantly (Chart 7).

The liquidity outflow caused by the rising amount of cash in circulation slowed down, with its movements being close to the level typical of this season. Demand for cash is still expected to gradually decrease to its pre-pandemic levels as economic activity returns to normal, yet this process will shift to 2021. Therefore, the forecast regarding the rise in the amount of cash in circulation in 2020 was increased from 1.4–1.6 to 1.9–2.1 trillion rubles.¹

In October, amid the outflow of liquidity through the fiscal channel, the Bank of Russia raised the threshold amount of liquidity provided at its one-month repo auction from 0.4 to 1.0 trillion rubles, so as to enable credit institutions to offset the currently unbalanced liquidity distribution and help them adjust to the changing situation. As a result, banks raised over 0.6 trillion rubles through these operations. The maximum amount of liquidity to be supplied for one month that was set by the Bank of Russia in November equalled 1.5 trillion rubles. Banks' demand totalled 1.2 trillion rubles.

Money market. The spread between short-term IBL² rates and the Bank of Russia key rate equalled -7 bp (in the September averaging period: -11 bp; since the beginning of 2020: -15 bp) (Chart 3). The spread volatility rose to 13 bp (vs 9 bp in the September averaging period; since the beginning of 2020: 18 bp). The outflow of liquidity from the banking sector through the fiscal channel caused short-term imbalances in liquidity distribution in October, which put upward pressure on IBL rates. Individual banks built up their net borrowings to process large transactions. In addition, as foreign currency liquidity slightly contracted (refer to the section 'Foreign currency liquidity'), this pushed up demand for rubles in the IBL segment on the part of individual market participants, which also contributed to the rise in IBL rates. Further on, as banks adjust to the changed situation with liquidity and shifts in the structure of long-term borrowings, overnight market rates are expected to decrease somewhat.

Although the easing related to the liquidity coverage ratio (LCR) for systemically important banks (SIBs) was cancelled beginning from October, this did not have any notable impact on IBL rates. When a bank raises funds in the short-term interbank lending market, this equally increases both its highly liquid assets (HLAs) as funds in its correspondent account and expected outflows as its debt on these operations. Therefore, the LCR cannot improve significantly as a result of these operations. The need to comply with the LCR incentivises banks to raise longer-term funds, thus helping even out the market yield curve in general. OFZ purchases enable banks to increase their HLAs. When banks raise funds under FT operations, they also improve their LCR since only 40% of this amount is accounted for in their expected outflows, while HLAs increase by 100% of these funds. The temporary rise in interest rates amid a rather drastic decline in the liquidity surplus was primarily the result of the time lag between the outflow of liquidity from the banking sector and the adjustment of banks' operations to the changed situation.

Foreign currency liquidity. The interest rate spread in the FX swap and IBL (basis) segments expanded, averaging -49 bp in the October averaging period (in the September averaging period: -33 bp; since the beginning of 2020: -18 bp) (Chart 4). The spread widened and the cost of foreign currency liquidity rose in the Russian market as non-residents built up their long ruble positions, which accordingly increased ruble lending in the FX swap segment, individual banks providing services to exporters reduced the supply of foreign currency in this segment, clients' liabilities decreased, a number of Russian companies made large eurobond repayments, and the cost of foreign currency liquidity slightly rose in global markets. Despite the persistent volatility in financial markets, in recent months non-residents first reduced their short ruble positions opened in March and then built up their long positions, purchasing rubles in the spot market and placing them in the FX swap segment to receive foreign currency. This may put downward pressure on implied ruble rates in the FX swap segment.

¹ Refer to [Monetary Policy Report No. 4, October 2020](#).

² The interbank lending rate is the interest rate charged on unsecured loans in the money market.

On the other hand, although banks rendering services to exporters reduced their supply of foreign currency, the banking sector still has a sufficient foreign currency liquidity cushion. The cost of foreign currency liquidity also remains considerably below its 2018 readings during the most recent period of banks' elevated demand for foreign currency and significant demand for the Bank of Russia's foreign currency refinancing instruments (USD/RUB sell/buy FX swaps), which is not the case now.

The **structural liquidity surplus forecast for the end of 2020** was lowered from 1.4–2.0 trillion rubles to 1.0–1.4 trillion rubles. This was because the 2020 forecast of the amount of cash in circulation was revised, and the Bank of Russia announced foreign currency sales in addition to the standard fiscal rule-based operations.

The end of the year is typically characterised by a higher volatility of autonomous liquidity factors. In terms of seasons, budget expenditures are shifted to the last weeks of the year. Moreover, Russia's Ministry of Finance started to raise funds for these expenditures in advance. The subsequent financing of expenditures will result in an inflow of funds into bank accounts. In addition, the FT will decrease the amount of funds placed with banks, which will largely

smooth out the effect of budget operations on liquidity by the end of the month. December commonly records a rise in demand for cash, but it may be lower than in previous years. The amount of cash in circulation increases over this period mostly because banks build up their cash balances to be able to replenish their cash offices and ATMs during the New Year holidays. Current cash holdings formed by households may lower their needs in withdrawing additional cash during this period.

The Bank of Russia carries out daily analysis of budget expenditures and cash and takes this information into account forecasting the banking sector liquidity. Therefore, if credit institutions receive budget expenditures earlier or demand for cash increases, the Bank of Russia will promptly adjust the limits on its liquidity management operations. This will enable the Bank of Russia to promptly balance the situation with liquidity at any point of time and achieve its operational objective, that is, maintain overnight money market rate close to the key rate.

Key rate expectations. Over the past months, analysts' and market participants' expectations remained unchanged. They assume that the key rate will be kept at 4.25% until the end of the year (Table 1).

MARKET PARTICIPANTS DO NOT EXPECT THE KEY RATE TO BE CUT THIS YEAR

Table 1

1. Expectations based on market indicators,* interest rate (instrument)	December 2020
– MosPrime 3M (FRA)	4.25 (4.36)
– RUONIA (ROISfix)	4.27 (4.33)
– RUONIA (futures)	4.46 (4.41)
2. Analysts' key rate expectations*	As of 31.12.2020
– Bloomberg survey	4.25 (4.25)
– Reuters survey	4.25 (4.25)

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

IN OCTOBER 2020, THE BANKING SECTOR'S STRUCTURAL LIQUIDITY SURPLUS DECREASED
(START OF BUSINESS, BILLIONS OF RUBLES)

Table 2

	01.01.2017	01.01.2018	01.01.2019	01.01.2020	01.10.2020	01.11.2020
Structural liquidity deficit (+) / surplus (-)	736	-2,639	-3,016	-2,761	-1,352	-680
Bank of Russia's claims on credit institutions	1,258	10	21	18	11	633
Auction-based facilities	216	-	-	-	5	628
– repos and FX swaps	-	-	-	-	5	628
– 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	1,967	1,931
Deposits	785	2,372	1,902	1,026	1,148	1,233
– auction-based	397	2,125	1,478	697	999	1,083
– fixed interest rate	388	247	424	330	149	150
BoR coupon bonds	0	357	1,391	1,956	819	699
Standing reverse facilities, other than standard monetary policy instruments of the Bank of Russia*	263	81	256	204	604	618

* 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 STRUCTURAL LIQUIDITY SURPLUS FORECAST FOR THE END OF 2020 WAS LOWERED
FROM 1.4–2.0 TRILLION RUBLES TO 1.0–1.4 TRILLION RUBLES
(TRILLIONS OF RUBLES)

Table 3

	2019 (actual)	January– October 2020	October 2020	2020 (forecast)
1. Liquidity factors	0.5	-2.1	-1.1	[-1.8; -1.5]
– change in the balances of funds in general government accounts with the Bank of Russia, and other operations*	0.2	0.1	-1.0	[0.3; 0.4]
– change in the amount of cash in circulation	-0.1	-2.2	-0.1	[-2.1; -1.9]
– 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	-0.1	0.0	-0.1
2. Change in free bank reserves (correspondent accounts)*** (demand)	0.7	0.0	-0.4	[-0.1; 0.0]
3. Change in banks' claims on deposits with the Bank of Russia and coupon OBRs	-0.3	-1.1	0.0	[-1.4; -1.0]
4. Change in outstanding amounts on Bank of Russia refinancing operations (4 = 2 + 3 - 1)	-0.1	1.0	0.6	0.5
Structural liquidity deficit (+) / surplus (-) (as of the period-end)	-2.8	-0.7		[-1.4; -1.0]

* 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.

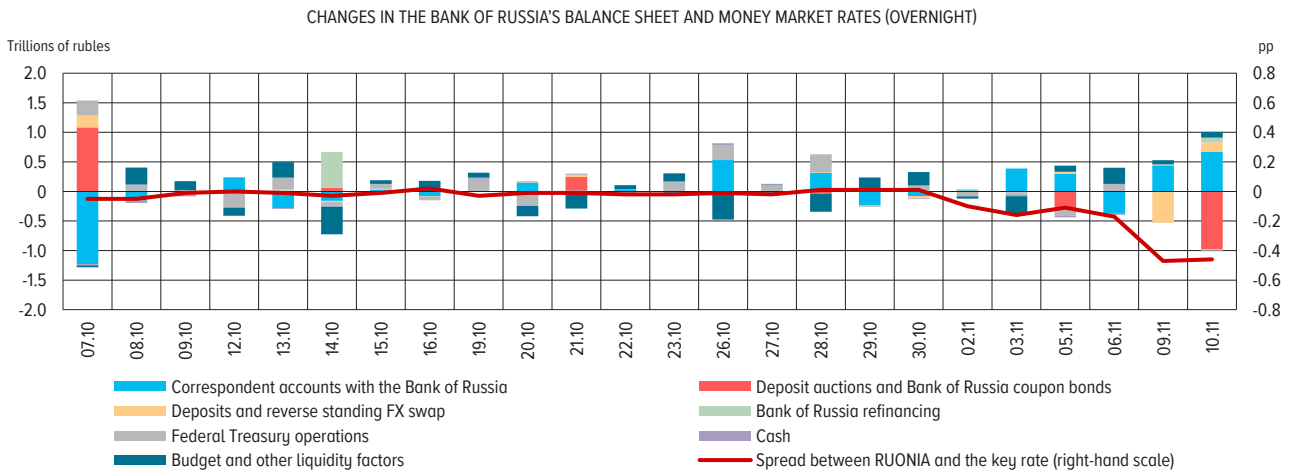
** Forecast values of the indicator are in line with the actual amount of operations conducted.

*** 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.

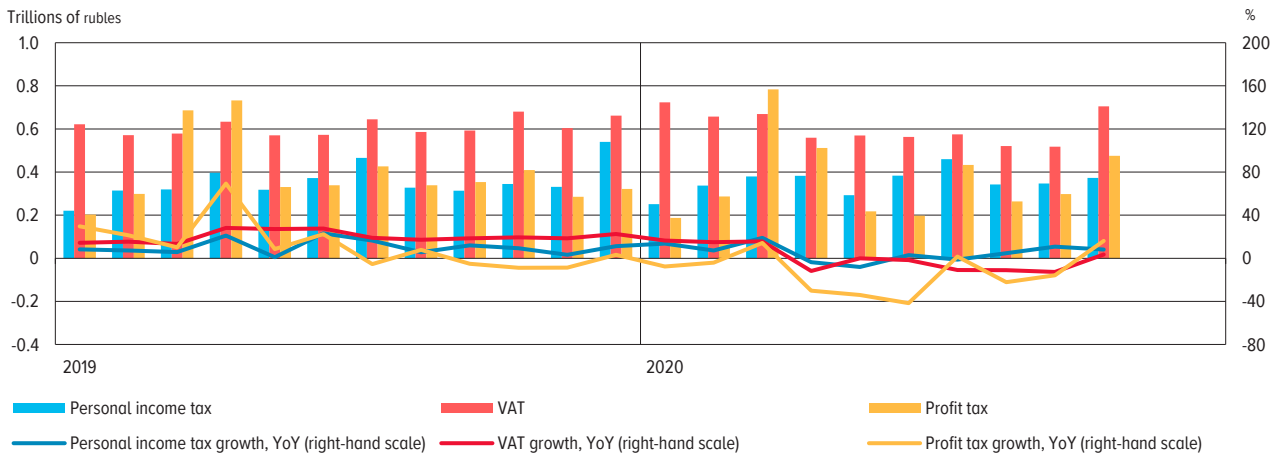
IN OCTOBER 2020, BUDGET OPERATIONS CAUSED AN OUTFLOW OF LIQUIDITY FROM THE BANKING SECTOR

Chart 1



TAX REVENUES ACCORDING TO DATA FROM THE BANK OF RUSSIA PAYMENT SYSTEM*
(% P.A.)

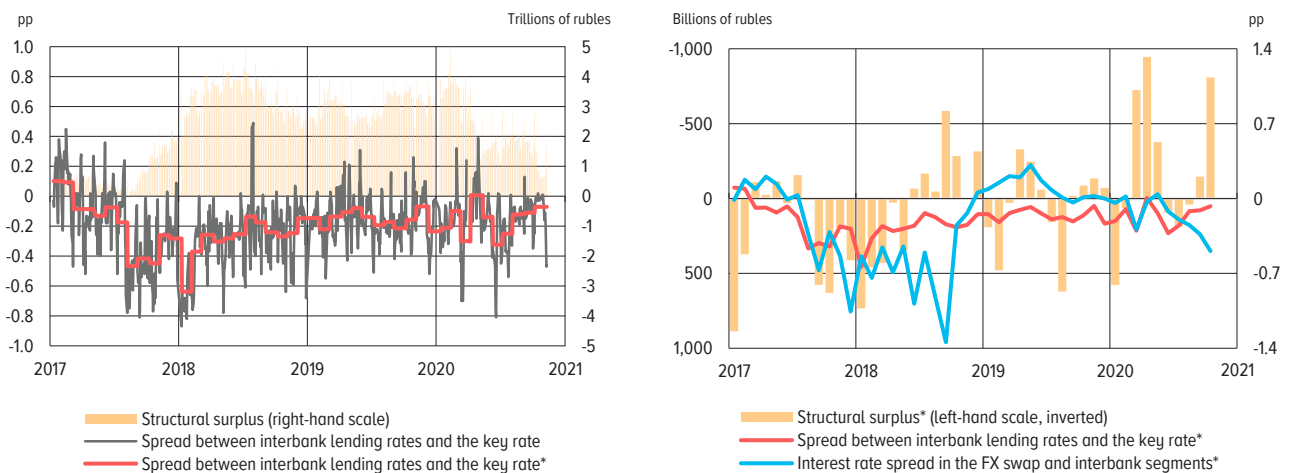
Chart 2



* Funds transfers from credit institutions' accounts to the budget system's accounts with budget classification codes corresponding to the above taxes.
Source: Bank of Russia calculations.

THE SPREAD BETWEEN INTERBANK LENDING RATES AND THE BANK OF RUSSIA KEY RATE CONTRACTED

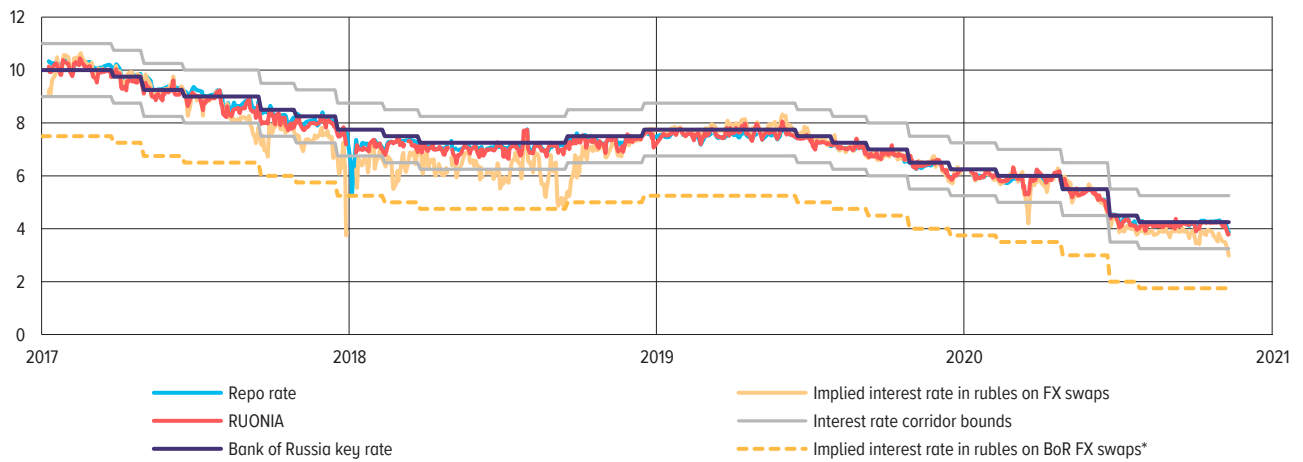
Chart 3



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

THE SPREAD IN THE FX SWAP AND INTERBANK LENDING SEGMENTS SLIGHTLY EXPANDED (% P.A.)

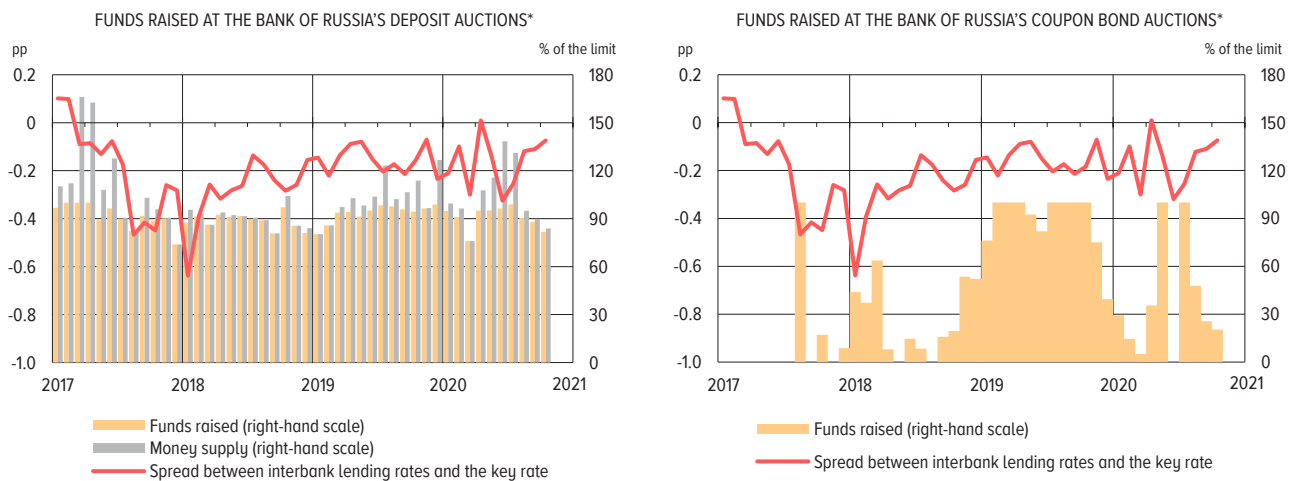
Chart 4



* 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 WAS SLIGHTLY BELOW THE ESTABLISHED LIMITS

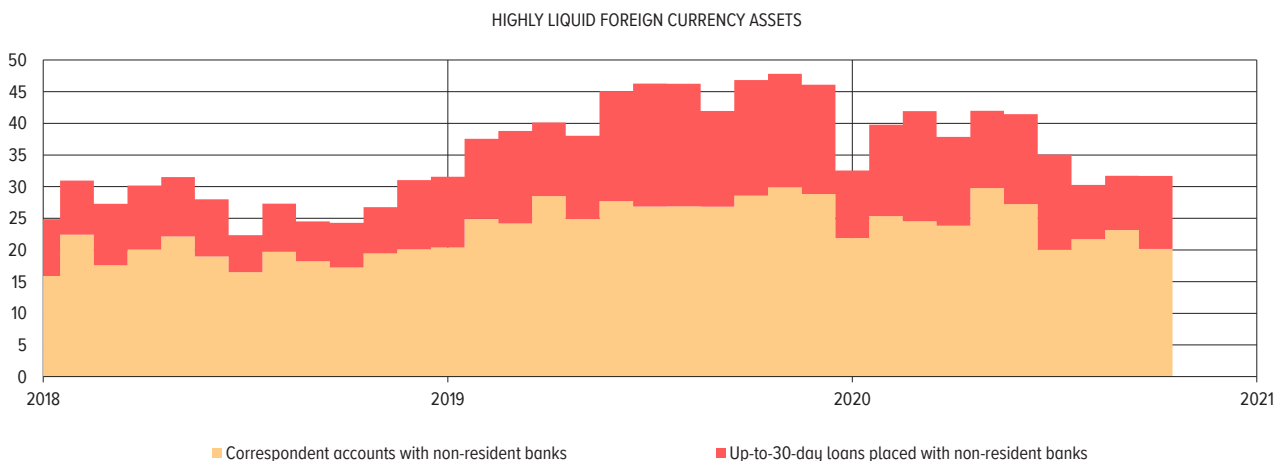
Chart 5



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

THE AMOUNT OF HIGHLY LIQUID FOREIGN CURRENCY ASSETS REMAINED UNCHANGED IN SEPTEMBER (ACCORDING TO DATA AS OF 1 OCTOBER) (BILLIONS OF US DOLLARS)

Chart 6

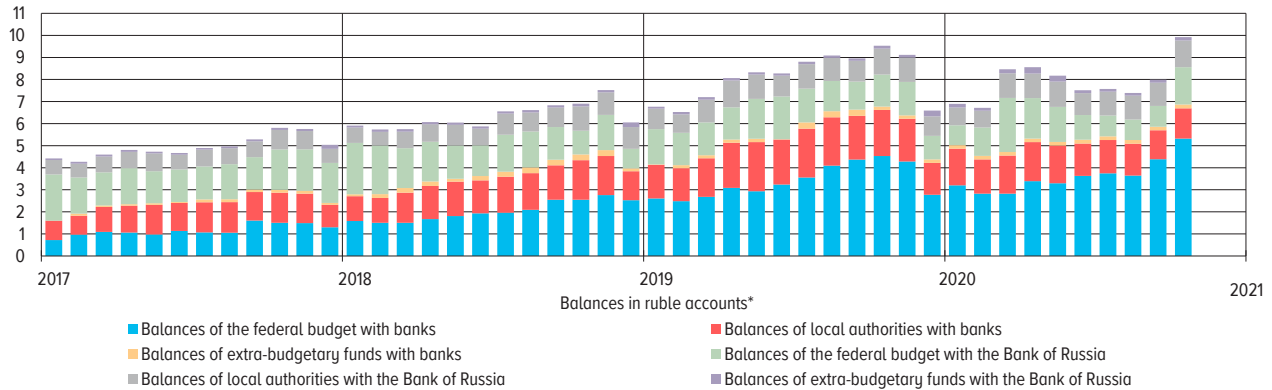


Source: Bank of Russia calculations.

IN OCTOBER 2020, BALANCES IN THE FEDERAL BUDGET ACCOUNTS WITH THE BANK OF RUSSIA EXPANDED AS A RESULT OF INCREASED TAX REVENUES, OFZ PLACEMENTS AND DIVIDEND PAYOUTS, WHICH WERE NOT FULLY OFFSET BY BUDGET EXPENDITURES AND THE HIGHER AMOUNT OF FUNDS PLACED WITH BANKS UNDER FT OPERATIONS

Chart 7

(TRILLIONS OF RUBLES, AS OF THE PERIOD-END)

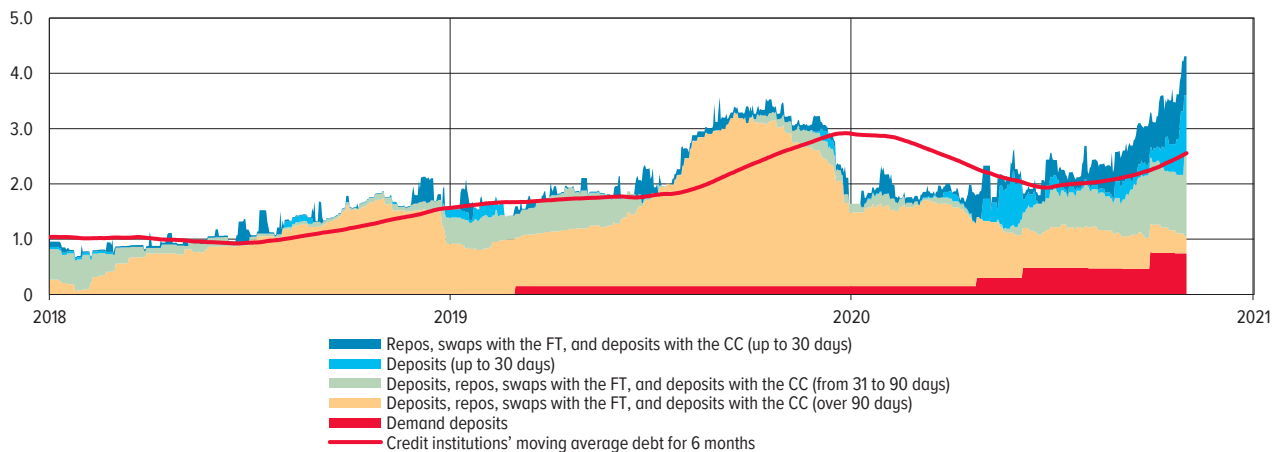


* According to banking reporting form 0409301 'Performance indicators of a credit institution'.
Source: Bank of Russia calculations.

CREDIT INSTITUTIONS' DEBT TO THE FEDERAL TREASURY INCREASED BY OVER 1 TRILLION RUBLES IN OCTOBER 2020

Chart 8

(TRILLIONS OF RUBLES)

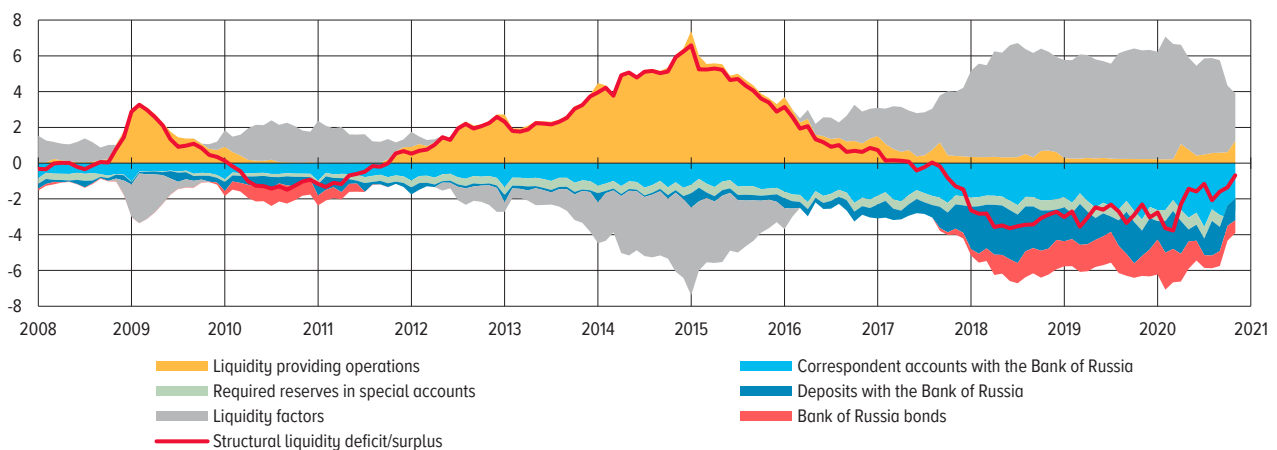


Sources: Federal Treasury, Bank of Russia calculations.

BANK OF RUSSIA'S BALANCE SHEET

Chart 9

(TRILLIONS OF RUBLES)



Source: Bank of Russia calculations.

Foreign exchange and stock markets

Early October was positive for global financial markets. Amid investors' expectations regarding the outcome of the US election and potential support measures for the US economy, the majority of countries recorded a rise in stock markets, a decline in CDS spreads, and the strengthening of their currencies against the US dollar. However, the second half of the month saw a new downturn in markets, including in Russia, since almost all countries suffered a surge in coronavirus cases and had to reintroduce lockdowns, tightening their restrictions to different extents.

Exchange rate. Beginning from late September and almost throughout October, the ruble was mostly strengthening against the US dollar, except some short periods of weakening caused by external factors. From 29 September to 23 October, the exchange rate of the ruble rose by 3.8%, to 76 rubles per US dollar, driven by both a positive external environment and gradually decreasing geopolitical risks. In particular, this is evidenced by the reduction in the CDS spread by 34 bp as of 21 October (the lowest level in October) and the resumption of OFZ purchases by non-residents. However, the ruble declined again during the last week of the month, losing 4.5% (Chart 10). This period also recorded a slump in prices in both stock markets (e.g. S&P 500 edged down 5.6%) and commodity markets and a depreciation of the currencies of most emerging market economies (EMEs). SIBs were the major buyers of foreign currency in October, while foreign investors accounted for the largest amount of purchases over the period when the ruble weakened the most (from 26 to 30 October). During this period, foreign currency they bought totalled 5.5 billion US dollars (in on-exchange and off-exchange markets). This could be explained by the reverse conversion of Sberbank dividends and the closing of long ruble positions in the run-up to the US election. Concurrently, investors were not closing long positions in the OFZ market.

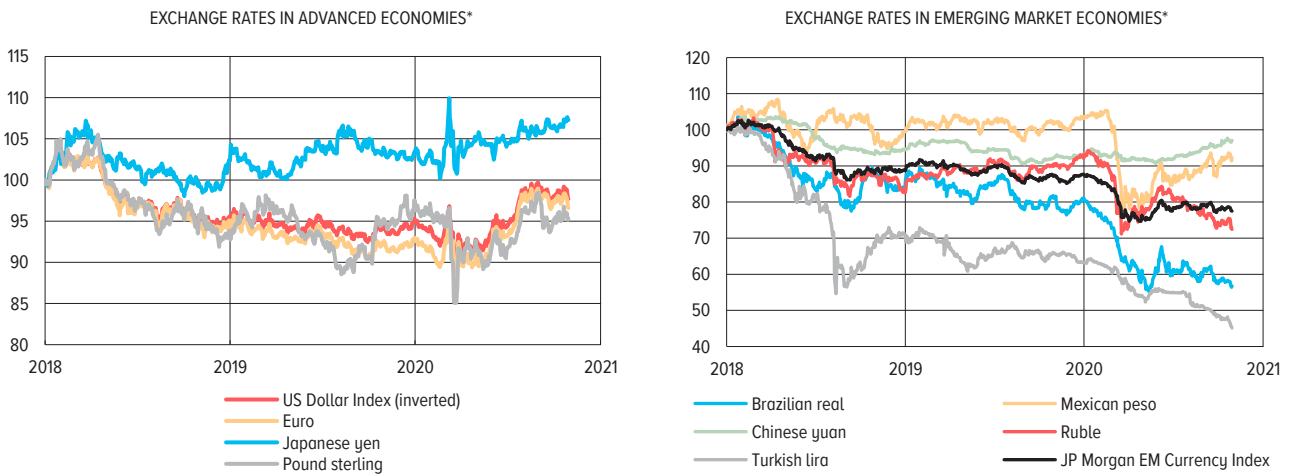
Country risk premium. As of the end of the month, Russia's 5-year CDS spread shrank by 19 bp, to 105 bp. At its lowest (21 October), the spread declined to 90 bp, which is the minimum since the middle of August 2020. CDS spreads in other EMEs were changing in a similar way (Chart 12). A number of EMEs, including South Africa, Turkey, Brazil, and Mexico, experienced a more significant decrease in CDS spreads than Russia.

Federal government bonds. Yields of short-term OFZ bonds increased, while long-term OFZ yields remained almost the same (Chart 12): OFZ 2Y – 4.40% (+12 bp), OFZ 5Y – 5.54 bp (-6 bp), and OFZ 10Y – 6.41 bp (-1 bp). Russia's Ministry of Finance continued extensive OFZ offerings, raising 1.5 trillion rubles over the month, which is its record high. Thus, the Q4 target for OFZ placements was achieved by 75%. The portion of SIBs in the structure of buyers expanded from 70% to 90%. Despite risk-off sentiment in global markets, non-residents did not reduce their OFZ holdings in the second half of the month. Contrastingly, they expanded by 43 billion rubles over the month (Chart 14).

Stocks. In the majority of countries, stock indices rose in the first half of the month and lowered at the end of the month. As a result, the month-on-month movements of indices varied from -11% to +5%, depending on the epidemiological situation in a particular country and other local factors. In contrast to other economies, Russian indices were going down nearly throughout the month. The MOEX Index was declining almost continuously since mid-August, while MSCI EM was predominantly growing. This might be explained by geopolitical risks, as well as oil price changes, and the estimates of demand for energy commodities in the coming quarters. According to EPFR Global, beginning from mid-August foreign investors withdrew nearly 325 million US dollars from the Russian market, while investing over 12 billion US dollars in other EMEs.

THE RUBLE LOST 4.5% DURING THE LAST WEEK, ERASING ITS GAINS OF THE FIRST HALF OF THE MONTH
(02.01.2018 = 100)

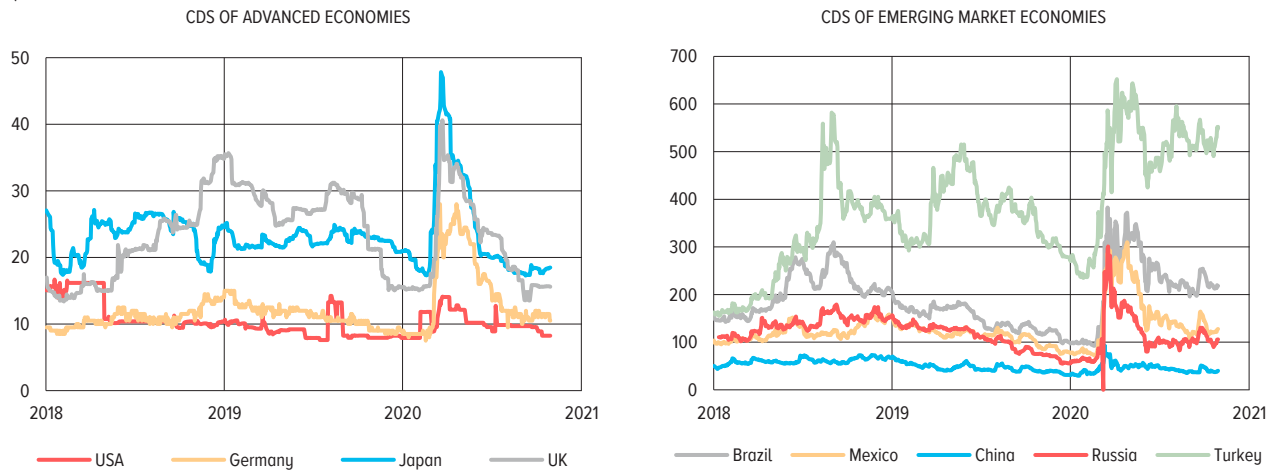
Chart 10



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

DESPITE RISK-OFF SENTIMENT, THE CDS SPREADS OF THE MAJORITY OF COUNTRIES REMAINED ALMOST UNCHANGED OVER THE MONTH
(BP)

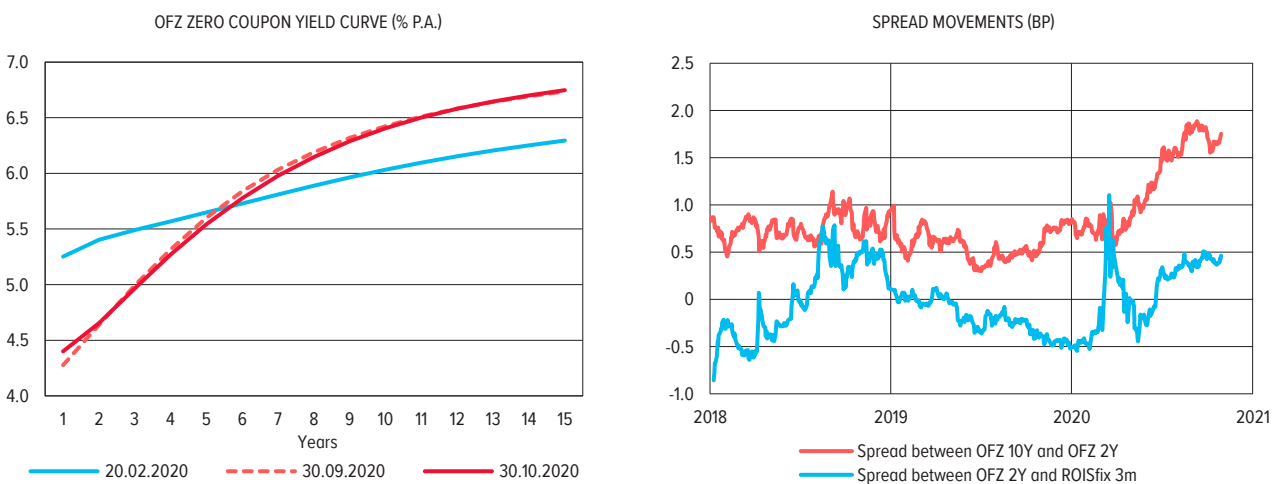
Chart 11



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

SHORT-TERM OFZ YIELDS INCREASED, WHILE LONG-TERM OFZ YIELDS REMAINED ALMOST THE SAME

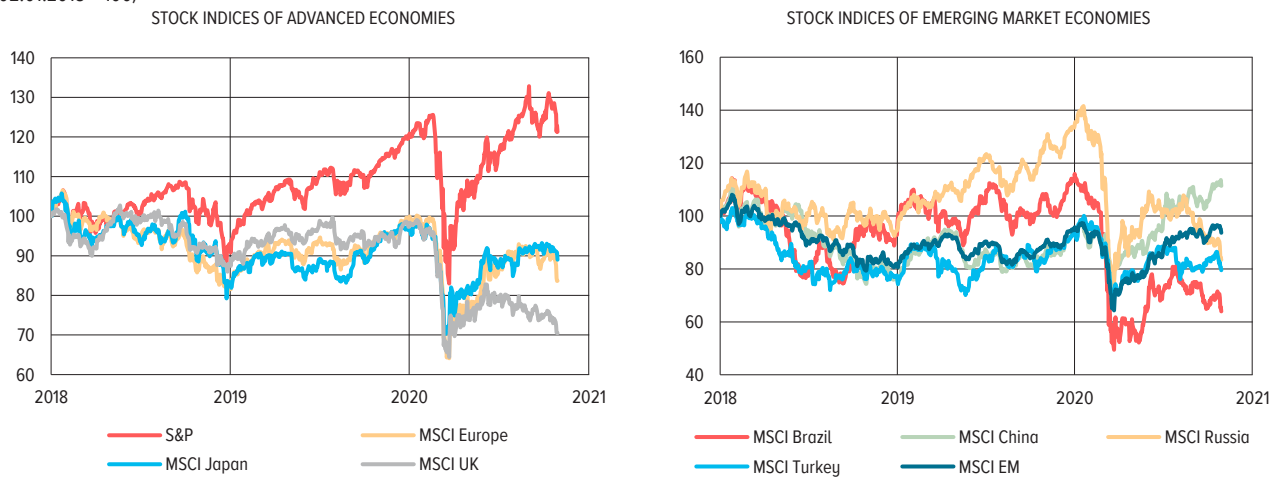
Chart 12



Source: PJSC Moscow Exchange.

IN CONTRAST TO THE MAJORITY OF OTHER EMES, THE RUSSIAN STOCK MARKET WAS DECLINING THROUGHOUT THE MONTH
(02.01.2018 = 100)

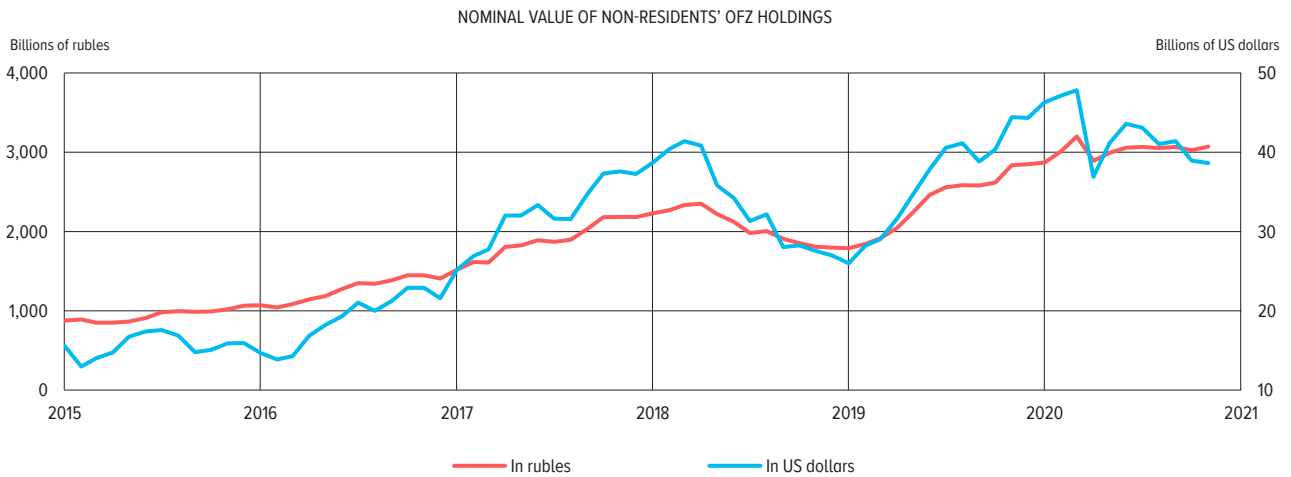
Chart 13



Sources: Bloomberg, Bank of Russia calculations.

FOREIGN INVESTORS' OFZ HOLDINGS CHANGED ONLY SLIGHTLY

Chart 14



Source: Bank of Russia calculations.

RISK-OFF SENTIMENT WAS OBSERVED IN MOST SEGMENTS OF THE FINANCIAL MARKET

Table 4

Indicator		30.10.2020	1M	3M	6M	YTD	1Y
Russian financial market							
RUB/USD exchange rate		79.53	-2.4	-6.9	-6.9	-28.3	-24.6
MOEX Index		2,691	-7.4	-7.6	1.5	-11.7	-7.6
RTS Index		1,067	-9.5	-13.6	-5.2	-31.1	-25.5
Government bond yield		5.84	-5	26	-6	-37	-51
Corporate bond yield		6.32	2	36	-28	-41	-68
Regional bond yield		5.80	4	4	-55	-47	-104
CDS spread		106	-18	1	-67	50	30
RVI		41	3	9	-3	19	21
Exchange rates (per US dollar, % change, '+' – appreciation, '-' – depreciation)							
AEs*	US Dollar Index	94.04	0.2	0.7	-5.1	-2.4	-3.7
	Euro	1.16	-0.6	-1.1	6.1	3.9	4.4
	Japanese yen	104.66	0.8	1.1	2.1	3.8	4.0
	Pound sterling	1.29	0.2	-1.1	3.5	-2.3	0.3
EMEs	JP Morgan EM Currency Index	54.29	-0.4	-2.4	2.8	-11.6	-11.3
	Ruble	79.53	-2.4	-6.9	-6.9	-28.3	-24.6
	Brazilian real	5.75	-2.4	-9.1	-4.4	-30.0	-30.5
	Mexican peso	21.18	4.4	5.1	16.1	-10.7	-9.9
	Chinese yuan	6.69	1.5	4.2	5.5	4.1	5.4
	Turkish lira	8.34	-7.5	-16.4	-16.0	-28.7	-31.7
	South African rand	16.24	3.1	5.1	15.8	-13.8	-7.6
10-year bond yield (% p.a., change in bp, '+' – increase, '-' – decrease)							
AEs	USA	0.88	19	35	26	-104	-90
	Germany	-0.63	-11	-10	-4	-44	-27
	Japan	0.04	3	2	7	6	16
	UK	0.26	3	16	1	-56	-42
EMEs	Russia	6.15	-9	22	4	-21	-28
	Brazil	7.64	28	137	5	96	140
	Mexico	6.28	17	57	-29	-61	-52
	China	3.18	4	21	67	4	-13
	Turkey	14.01	115	151	269	206	122
	South Africa	9.30	-12	7	-96	28	17
CDS spreads (% p.a., change in bp, '+' – increase, '-' – decrease)							
AEs	USA	8	-1	-2	-4	0	0
	Germany	11	-2	-2	-13	2	1
	Japan	18	0	0	-14	-2	-4
	UK	16	0	-4	-16	0	-6
EMEs	Russia	106	-18	1	-67	50	30
	Brazil	218	-31	0	-98	119	100
	Mexico	128	-24	-16	-131	49	38
	China	40	-9	-3	-8	9	0
	Turkey	552	24	-1	-53	275	223
	South Africa	276	-36	-30	-152	114	97
Stock indices (points, % change, '+' – increase, '-' – decrease)							
AEs	S&P	3,270	-2.8	0.0	15.5	1.2	7.3
	MSCI Europe	1,505	-5.7	-5.4	6.6	-15.7	-11.5
	MSCI Japan	957	-2.54	4.9	10.6	-7.8	-4.9
	MSCI UK	1,562	-5.3	-6.1	-4.6	-27.6	-25.7
EMEs	MSCI EM	1,103	2.0	2.3	20.4	-1.0	5.9
	MSCI Russia	505	-9.9	-16.5	-9.5	-37.4	-33.8
	MSCI Brazil	1,340	-2.6	-18.2	10.0	-43.5	-40.4
	MSCI Mexico	3,599	2.2	3.6	17.0	-24.4	-23.7
	MSCI China	103	5.3	8.0	28.2	20.0	31.9
	MSCI Turkey	1,283,426	-4.9	-3.3	0.0	-14.6	-3.6
	MSCI South Africa	1,238	-2.1	-6.4	3.5	-9.7	-7.4

* Advanced economies.

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

Credit and deposit market

Deposit rates. In September, the decrease in interest rates on retail deposits expectedly discontinued as the key rate was not revised and OFZ yields rose (Chart 15). As of the end of the month, average market rates on both short- and long-term loans even adjusted upwards a little – by 8 and 3 bp, respectively.¹ The only exception was the segment of deposits with maturities of over three years where the average interest rate continued to go down, although considerably more slowly than in August.

In October, banks continued to launch new seasonal deposits, and a range of market participants even announced a slight rise in interest rates on standard deposit products, seeking to support the attractiveness of this investment instrument for depositors. Since banks' competition for stable retail funding is high, this will probably hold average market deposit rates close to the current level as of the end of the month.

Conversely, the cost of foreign currency deposit products mostly continued the downward trend. Average market interest rates on short- and long-term US dollar deposits hit their new record lows in September, evidencing banks' low interest in expanding their foreign currency assets and liabilities.

Deposit operations. Although real returns on deposits declined and households continued to demonstrate high demand for cash, households' saving activity remained almost unchanged in September, staying moderate overall, with the annual growth of household deposits totalling 6.6%² against 6.8% in the previous month (Chart 16). Moreover, the structure of deposit operations continued to change in September,

extending this trend observed since the start of the coronavirus pandemic.

As before, record-low interest rates on foreign currency deposits, coupled with uncertain exchange rate expectations, supported the foreign currency substitution trend in the deposit market (Chart 16). By early October, the decrease in foreign currency deposits sped up to 8.6% in annualised terms, compared to 6.5% as of the end of August. Contrastingly, ruble deposits continued to trend up, with their annual growth accelerating from 10.6% to 11.0% over September. Although the share of retail foreign currency deposits increased from 20.7% to 21.4%, this was solely caused by the ruble's weakening over the said period.

As before, short-term operations (predominantly, deposits for up to 30 days, including demand deposits) were the major contributor to the deposit growth in the ruble segment of the market, while long-term operations mostly contained the expansion of the retail deposit portfolio (Chart 16). The segment of deposits with maturities of up to one year was supported to a certain extent owing to the dynamics of balances in escrow accounts driven by the upward trend in the market of project financing in equity housing construction in 2020.

Credit rates. After the diverse changes in July, the cost of borrowing was declining in August across the majority of segments of the corporate³ credit market. Weighted average interest rates on short- and long-term loans hit their new record lows (Chart 15). Specifically, the interest rate on loans granted for up to one year dropped by 0.3 pp, to 6.0%, with preferential lending still accounting for a considerable portion of such loans. Another important contributor to the decrease in the average rate in this market segment was operations with both large corporates and small and medium-sized enterprises (SMEs), primarily in the wholesale and retail industries. As regards loans with maturities of over one year, the average interest rate declined by 0.5 pp, to 7.0%. This was associated with the downward

¹ Short-term deposits are deposits with any maturities up to one year, excluding demand deposits; long-term deposits are deposits with any maturities of over one year.

² 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.

³ Hereinafter, the corporate segment of the credit market implies lending to non-financial organisations.

trend of interest rates on loans issued to large corporates. Contrastingly, the interest rate in the higher-risk segment of long-term SME lending remained close to its July's level.

Interest rates in retail lending were moving diversely in September, with the average rate on household loans for up to one year increasing by 0.3 pp and on loans for more than one year – falling by 0.4 pp. The main reason for the reduction in the average interest rate on long-term retail loans was the decreased market share of car and unsecured consumer loans amid the slower recovery of consumer activity,⁴ which was also coupled with a slight decline in interest rates on these types of loans.

Conversely, the cost of ruble-denominated mortgage loans was up to 7.32% in September, which is 0.16 pp higher compared to its record low in August. This trend of the mortgage rate was mostly explained by the increased market share of loans granted to purchase finished housing. Nonetheless, as a result of the preferential mortgage lending programme, the weighted average interest rate in the new housing market stayed close to its record lows, adjusting upwards by 5 pp in September, to total 5.93%. This trend was explained by the higher affordability of mortgage loans for various groups of households. In addition, the average principal and maturity increased.

Given that the Bank of Russia did not change the key rate in September–October, interest rates may be expected to stay low in the next months, close to the level reached by August–September. Interest rate fluctuations around this level will largely depend on the market share of government-funded preferential programmes and demand for loans among higher-risk borrowers.

Corporate lending. Corporate lending remained steady in September, with the annual growth of loans to non-financial organisations equalling 6.3%, which is close to the previous month (Chart 17). The portion of overdue loans in the corporate portfolio was decreasing for the second consecutive month.

The portfolio of loans granted to non-financial organisations expanded in September owing to

the foreign currency segment, with the annual growth of foreign currency lending reaching 4.5%, up from 3.0% in the previous month, primarily driven by large one-off transactions. In contrast, ruble lending slightly slowed down, which was associated with, among other things, the decline in corporate demand for borrowing to support business continuity. Consequently, borrowers started to substitute short-term loans with long-term ones in September: the annual growth of ruble loans for up to one year reached 6.4% against 6.2% in the previous month, while lending for less than one year contracted to 9.6% from 12.9% in August.

The slowdown in the segment of ruble-denominated corporate loans was also caused by the continuing growth in the bond market. Moreover, credit institutions are also extensively investing in this market, building up their portfolios of bonds, including corporate ones. As of the end of September, non-financial issuers expanded their bond portfolio by 1.2 trillion rubles in annualised terms, which is twice as much as last year.

In the short run, the bond market may be expected to grow significantly, including owing to the funds of retail investors: amid the accommodative monetary policy and decreased deposit rates, individuals are demonstrating higher demand for stock market instruments generating higher returns. Concurrently, corporate lending will probably continue to grow steadily, supported by recovering demand for borrowing expected by the banks participating in the bank lending conditions (BLCs) survey (Chart 19), the easing of non-price BLCs in Q3, and the existing preferential lending programmes.

Retail lending. Activity in the retail lending market remained high in September, with the portfolio of household loans expanding by 1.8% compared with 1.9% in the previous month. The growth in retail lending was driven by the easing of both price and non-price lending conditions recorded by the banks participating in the BLC survey in 2020 Q3 (Chart 19).

As before, mortgage lending was the main contributor to the expansion of the retail loan portfolio, including owing to the 6.5% preferential mortgage lending programme (Chart 18). The

⁴ Refer to *Economy: Facts, Assessments and Comments*, No. 8 (56), August 2020.

amount of ruble-denominated mortgage loans disbursed in September exceeded 500 billion rubles, hitting its record high. As a result, the annual growth of the mortgage portfolio⁵ sped up by 2.0 pp, to 18.6%. As the preferential lending programme in the new housing segment was extended until 1 July 2021, mortgage lending will most likely remain the key driver of retail lending.

The segments of car and unsecured consumer loans continued recovery growth, although it was less significant than in August due to the slower revival of consumer activity.⁶ Specifically, the portfolio of car loans expanded by 0.9% against 1.5% in the previous month, and the growth in unsecured lending trended down to 1.1%, from 1.6% the month before.

The six-month loan repayment holidays granted to borrowers hit by the coronavirus pandemic who had been the first to apply for deferrals ended in September. Nonetheless, the quality of the retail loan portfolio remains stable. As of the end of September, the portion of overdue loans in the retail portfolio decreased by 0.1 pp, to 4.7% (Chart 17). As the borrowers who were granted loan repayment holidays gradually resume their payments according to the original schedule, the percentage of overdue loans may be expected to rise slightly more in the short run. The growth of overdue loans will be contained by two main factors. Firstly, households have improved their capabilities to service their liabilities, demonstrating lower demand for loan restructuring (according to the BLC survey in 2020 Q3) owing to the partial recovery of their incomes. Secondly, the Bank of Russia has recommended that banks implement their in-house loan restructuring programmes⁷ if borrowers apply for restructuring during the period from 1 October through 31 December 2020.

Money supply. In September, the annual growth of the banking system's claims on

the economy⁸ equalled 9.3%, close to the previous month's level. Moreover, corporate debt expanded by 8.0%. However, in contrast to August, this increase was primarily driven by operations with financial institutions, while claims on non-financial organisations contracted in September (due to the foreign currency segment). Claims on households continued to bounce back steadily, largely supported by the record-high activity in the mortgage market, with the annual growth reaching 12.9% as of early October against 12.6% the month before.

Although budget expenditures and revenues contracted somewhat in September,⁹ the banking system's net claims on the general government continued to increase their positive contribution to the growth of money supply (Chart 20). This was partially offset because of a decrease in the contribution of the banking system's net foreign assets, predominantly associated with fiscal rule-based operations. As a result, coupled with the sustainable growth of claims on the economy, the annual growth of the M2X and M2 monetary aggregates remained almost unchanged compared to August, equalling 11.8% and 16.1%, respectively (on average over the last two years – 8.3% and 11.0%, respectively).

As regards the structure of money supply in September, the trends of the previous months continued, with ruble deposits of the non-financial sector remaining the key component of M2X and foreign currency deposits still hindering the growth of this monetary aggregate. In addition, the contribution of the amount of cash in circulation outside the banking system to the money supply growth remained increased, which was likely associated with the uncertainty over the further spread of the coronavirus.

⁵ Housing mortgage loans, net of claims on such loans acquired by banks.

⁶ Refer to *Economy: Facts, Assessments and Comments*, No. 8 (56), August 2020.

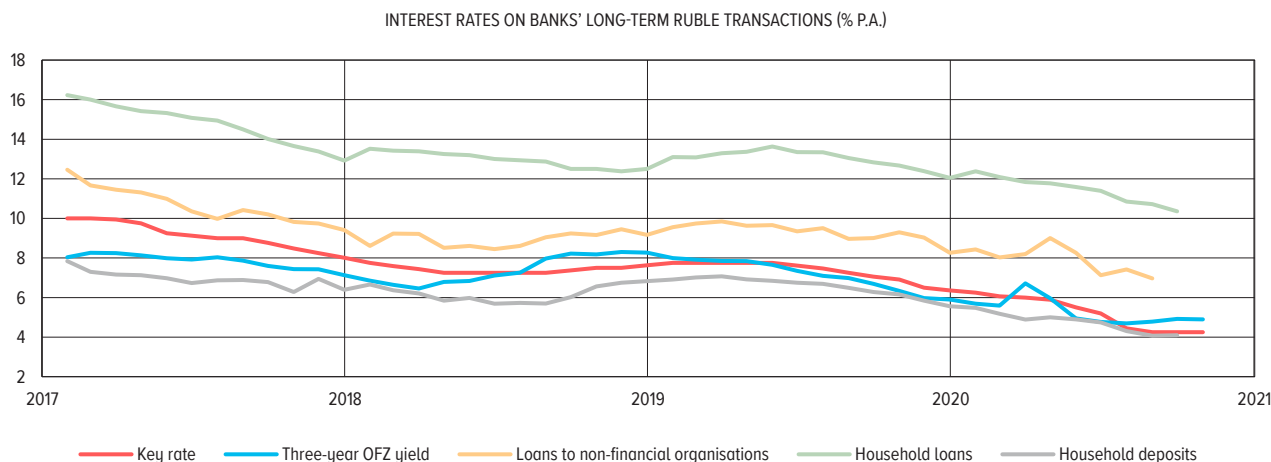
⁷ Refer to *Retail and Corporate Loan Restructuring*, No. 8, 12 October 2020.

⁸ 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.

⁹ Refer to *Banking Sector Liquidity and Financial Markets: Facts, Assessments and Comments*, No. 9 (55), September 2020.

THE DECREASE IN DEPOSIT RATES DISCONTINUED IN SEPTEMBER

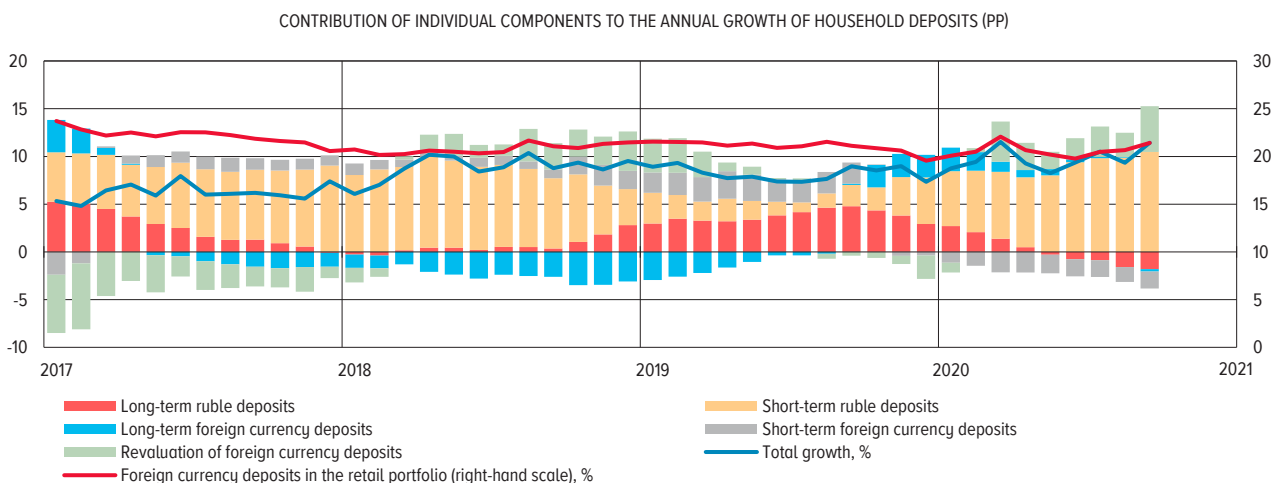
Chart 15



Source: Bank of Russia.

THE RETAIL DEPOSIT PORTFOLIO CONTINUES TO EXPAND MODERATELY

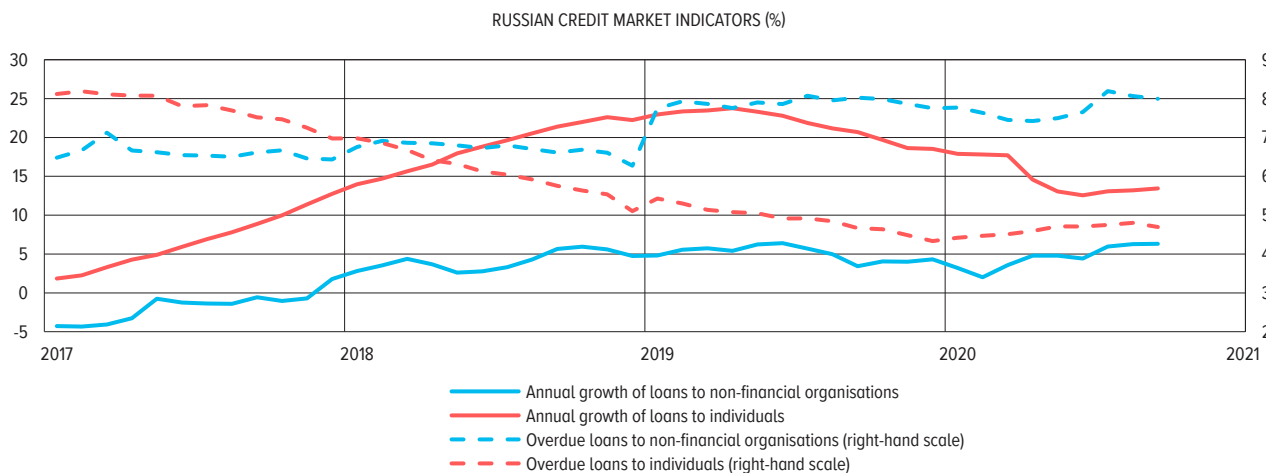
Chart 16



Source: Bank of Russia calculations.

CORPORATE LENDING CONTINUES A STABLE UPWARD TREND

Chart 17

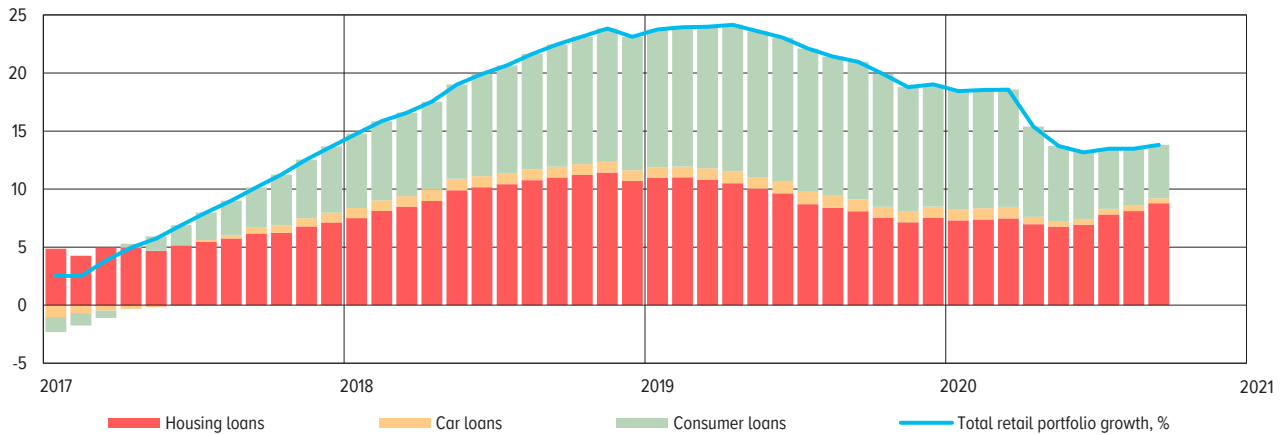


Source: Bank of Russia calculations.

IN SEPTEMBER, THE REVIVAL IN CAR AND UNSECURED CONSUMER LENDING SLOWED DOWN, WHILE MORTGAGE LENDING DEMONSTRATED RECORD-HIGH GROWTH

Chart 18

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

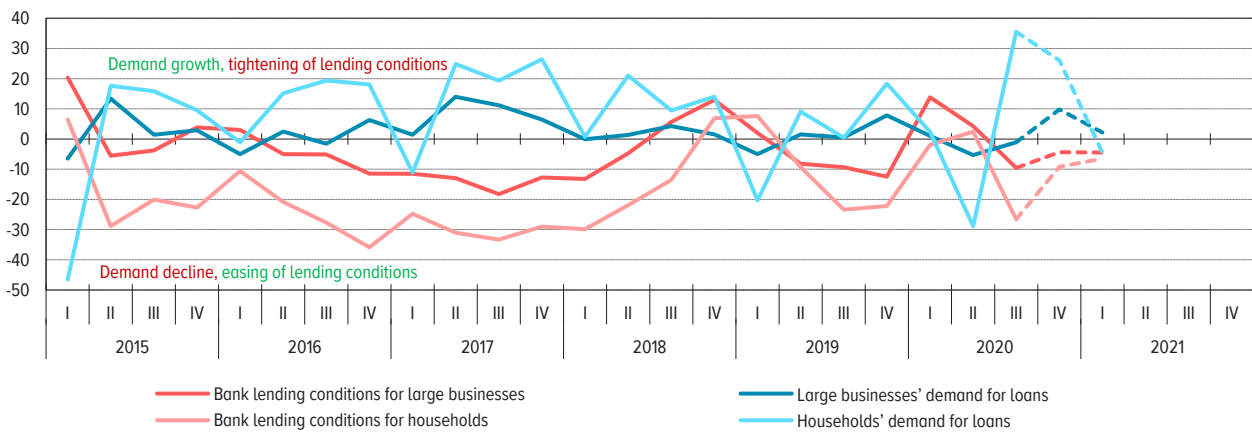


* For loans grouped into homogeneous loan portfolios.
Source: Bank of Russia calculations.

IN 2020 Q3, BANKS RESUMED THE EASING OF NON-PRICE LENDING CONDITIONS FOR ALL MAIN CATEGORIES OF BORROWERS

Chart 19

INDICES OF LENDING CONDITIONS AND DEMAND FOR LOANS (PP)

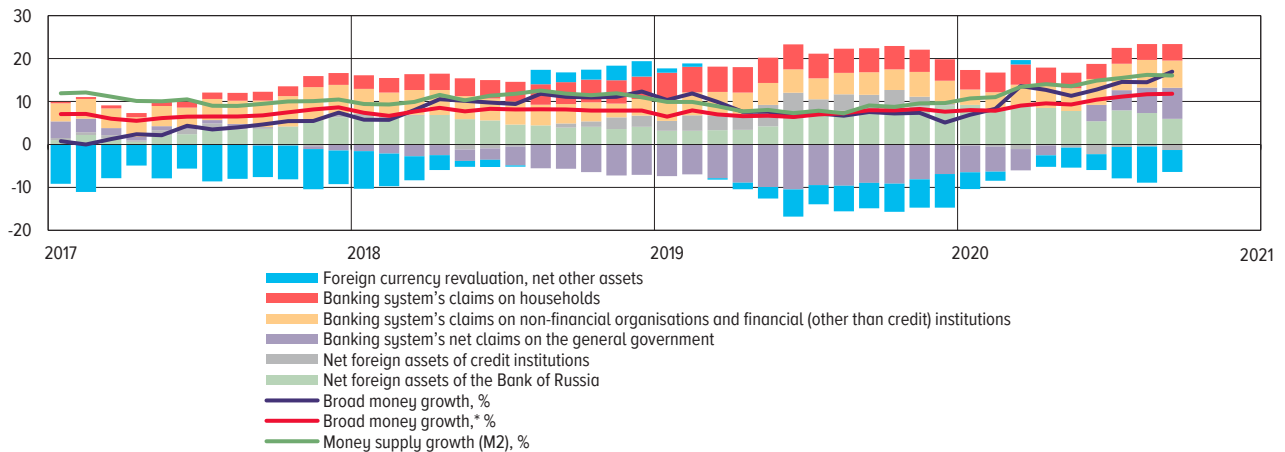


* The dotted lines signify respondent banks' expectations regarding changes in lending conditions and demand for loans in 2020 Q3.
Source: Bank of Russia.

BUDGET OPERATIONS CONTINUE TO BOOST MONEY SUPPLY

Chart 20

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



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

CREDIT AND DEPOSIT MARKET INDICATORS

Table 5

		June 2020	July 2020	August 2020	September 2020
Interest rates on banks' long-term ruble transactions					
– household deposits	% p.a.	4.7	4.3	4.1	4.1
– household loans	% p.a.	11.4	10.9	10.7	10.4
– corporate loans	% p.a.	7.1	7.4	7.0	-
Household deposits	% YoY, AFRC	7.2	7.3	6.8	6.6
– in rubles	% YoY	10.9	11.3	10.6	11.0
– in foreign currency	% YoY	-6.7	-7.2	-6.5	-8.6
– share of foreign currency	%	19.8	20.5	20.7	21.4
Loans to non-financial organisations	% YoY, AFRC	4.4	6.0	6.3	6.3
– short-term (up to 1 year)	% YoY, AFRC	15.0	11.3	14.0	14.2
– long-term (more than 1 year)	% YoY, AFRC	2.1	4.1	4.1	4.1
– overdue loans	%	7.7	8.2	8.1	8.0
Household loans	% YoY, AFRC	12.6	13.1	13.2	13.4
– housing mortgage loans	% YoY, AFRC	13.7	15.7	16.6	18.6
– unsecured consumer loans	% YoY	11.2	10.1	9.5	8.9
– overdue loans	%	4.7	4.8	4.8	4.7
Banking system's claims on the economy	% YoY, AFRC	8.8	9.0	9.3	9.3
– on businesses	% YoY, AFRC	7.6	7.7	8.1	8.0
– on households	% YoY, AFRC	12.0	12.4	12.6	12.9
Money supply (M2 monetary aggregate)	% YoY	14.9	15.5	16.2	16.1
Broad money	% YoY, AFRC	10.4	11.1	11.7	11.8

Note: YoY – year-on-year; AFRC – 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 – 10.11.2020 (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 required reserves averaging periods. In October–November 2020, this period is from 07.10.2020 to 10.11.2020);
- 'Foreign exchange and stock markets' section – 30.10.2020;
- 'Credit and deposit market' section – 01.10.2020.

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.

This commentary was prepared by the Monetary Policy Department.

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