



Bank of Russia

The Central Bank of the Russian Federation



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December 2018

BANKING SECTOR LIQUIDITY AND FINANCIAL MARKETS

Facts, assessments and comments

Moscow

Cut-off date:

'Banking sector liquidity and money market'* section – 8 January 2019;

'Foreign exchange and stock market' section – 29 December 2018.

'Credit and deposit market' section – 1 December 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 account required reserves averaging periods. In December 2018, this is the period between 5 December 2018 and 8 January 2019.

A soft copy of the information and analytical material is published on the Bank of Russia website (<http://www.cbr.ru/DKP/>).

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

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

- *In December, the structural liquidity surplus grew amid traditionally high end-year revenues of the banking sector via budget accounts.*
- *Short-term interbank lending rates approached the key rate, given the rebound in demand for ruble liquidity in the market.*
- *The FX liquidity position remained favourable. In contrast to previous years, interest rates in the FX swap segment did not demonstrate elevated volatility closer to the year-end.*
- *In November-December 2018, banks continued to expand lending to the economy. As before, household lending grew most rapidly which was in part supported by a drop in retail lending rates amid a slight growth in corporate lending rates.*
- *The situation in the Russian financial market remained relatively stable in December despite massive selling in the markets of most advanced economies and the global oil price downturn.*
- *In the middle of December, the Bank of Russia decided to raise the key rate by 25 bp. Despite the fact that not all market participants expected the key rate increase in December, the taken decision did not exert any material impact on the future key rate path.*

Banking sector liquidity and money market

Ruble liquidity. In December, the structural liquidity surplus reached 3.0 trillion rubles, thereby exceeding the Bank of Russia's forecast standing at 2.0-2.3 trillion rubles unveiled in the previous comments. The factors underpinning the increase in liquidity surplus were mainly traditionally high end-year volume of operations across budget accounts. The Federal Treasury and budgets of Russian constituents reduced the volume of funds placed with banks in deposit and repo accounts, though to a lesser degree than expected. Balances of accounts held with the Bank of Russia, including balances received as a result of the conversion of the National Wealth Fund's money were used to execute the planned expenses. This caused liquidity inflow to the banking sector through the budget channel.

Another factor behind the deviation of the current liquidity surplus from the forecast level was the outpacing implementation of required reserves averaging by banks, which reduced balances on their correspondent accounts and caused a respective increase in overnight deposits at the Bank of Russia. The Bank of Russia's liquidity forecast assumptions imply an even trajectory of required reserve averaging by credit institutions and a slight seasonal increase in balances of correspondent accounts on the last day of the year. The end of 2018 fell on the last business day before the completion of the required reserves averaging period. Changes in the technology of overnight deposit operations and the extension of their

timeframes helped banks to settle their liquidity position as of the end of the operational day. Banks deposited excessive funds on their accounts with the Bank of Russia and held their account balances sufficient to fulfil required reserve ratio. In this situation, some banks received additional funds in their correspondent accounts in repo operations conducted by the Bank of Russia payment system during the New Year holidays.

Cash in circulation was close to last year readings. At end-December, this factor shaped a slightly smaller liquidity outflow from the banking sector than forecast due to the partial return of cash money to banks on the last day of the month.

Money market. The spread of short-term rates in the interbank segment of the money market to the Bank of Russia key rate narrowed by 10 bp to -15 bp. This was assisted by large banks' resumed demand for ruble liquidity amid a reduction in Bank of Russia standing lending facilities. Nonetheless, a small spread remained because Bank of Russia deposit auctions failed to attract enough funds. At the end of December, large tax payments did not have a material impact on the spread due to the inflow of funds through the budget channel during several last days of the month.

FX liquidity. Interest rate spreads in the FX swap and interbank segments remained close to zero. Relatively low cost of foreign currency borrowings in the local market continued to be shaped by inflows of funds to the current account amid the suspension of fiscal rule-based purchases of foreign currency till the end of 2018. As earlier, December saw a surge in

customer foreign currency deposits at banks servicing exporters.

During several last days in December, interest rates in the FX swap segment remained stable, in contrast to the situation at end-2017 when there was registered a short-lived surge in the cost of FX borrowings. The persistently favourable situation with foreign currency liquidity observed in the last months of 2018 led to the absence of a considerable expansion in banks' demand for foreign currency during last days of the year. In these settings, banks did not demonstrate a significant demand for FX borrowings via Bank of Russia FX swaps, as was the case during several past years.

Table 1

The trajectory of interest rates expected by market participants did not change significantly

1. Expectations based on market indicators* interest rate (instrument)	April 2019	July 2019
- MosPrime 3M (FRA)	9.05 (9.02)	9.53 (9.35)
- RUONIA (ROISfix)	8.07 (7.88)	8.44 (8.47)
- RUONIA (futures)	7.93 (7.95)	8.24 (8.26)
2. Analysts' expectations for the key rate*	As of 31.03.2019	As of 30.06.2019
- Bloomberg survey	7.75 (7.75)	7.75 (7.5)
- Reuters survey	7.75 (7.75)	7.75 (7.75)
3. Implied inflation rate (OFZ-IN) (until 16 August 2023)	5.11 (5.07)	

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

Source: Bank of Russia calculations.

Table 2

Structural liquidity surplus forecast for end-2019 has been raised after the revision of actual data for December 2018

(trillions of rubles)	2018	December 2018	2019 (forecast)
1. Liquidity factors (supply)	0.6	0.2	[0.2; 0.7]
- changes in the balances of general government accounts with the Bank of Russia, and other operations*	0.6	0.7	[0.9; 1.3]
- change in cash in circulation	-0.6	-0.5	[-0.7; -0.6]
- Bank of Russia interventions in the domestic FX market and monetary gold purchases**	0.7	0.0	0.0
- regulation of banks' required reserves with the Bank of Russia	-0.1	0.0	0.0
2. Change in free bank reserves (correspondent accounts) (demand)	0.0	-0.1	0.4
3. Change in banks' claims on deposits with the Bank of Russia and coupon OBRs	0.6	0.0	[-0.2; 0.3]
4. Change in outstanding amounts on Bank of Russia re-financing operations (4 = 2 + 3 - 1)	-0.1	-0.3	0.0
Structural liquidity deficit (+) / surplus (-) (as of the period-end)	-3.0		[-3.3; -2.8]

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

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

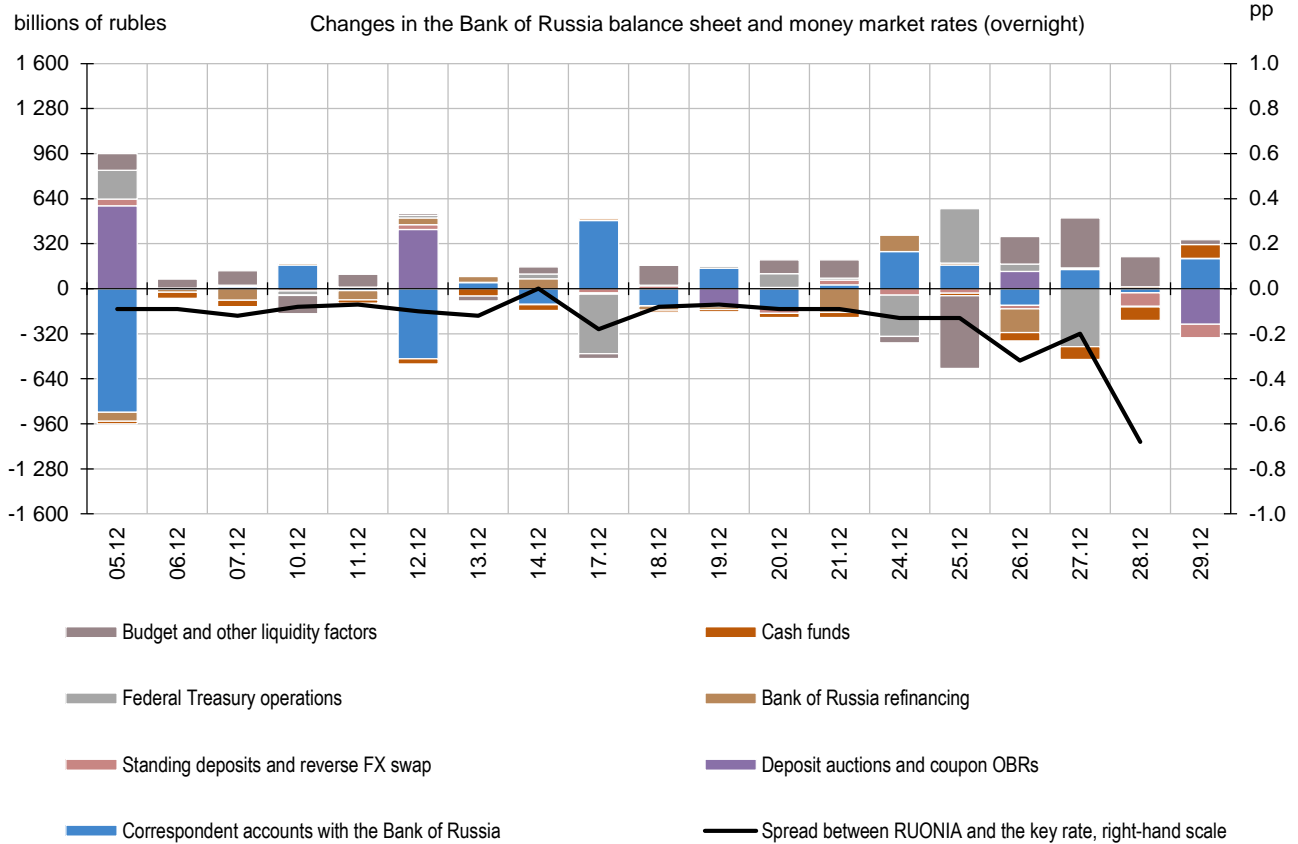
Source: Bank of Russia calculations.

End-2019 forecast of the structural liquidity surplus has been raised from 2.2-2.8 trillion rubles to 2.8-3.3 trillion rubles after the actual December 2018 data were revised.

In the middle of December, the Bank of Russia decided to raise the key rate by 25 bp. Despite the fact that not all market participants expected the key rate increase in December, the taken decision did not exert any material impact on the future key rate path.

Chart 1

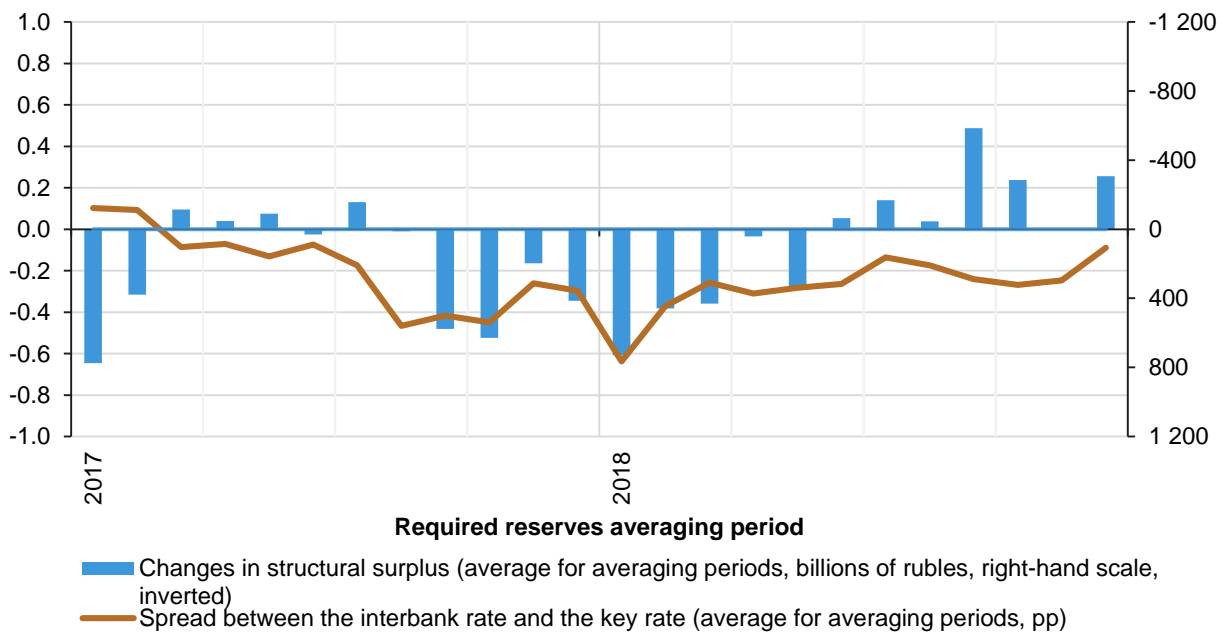
The factors underpinning increase in liquidity surplus were mainly traditionally high end-year volume of operations across budget accounts



Source: Bank of Russia calculations.

Chart 2

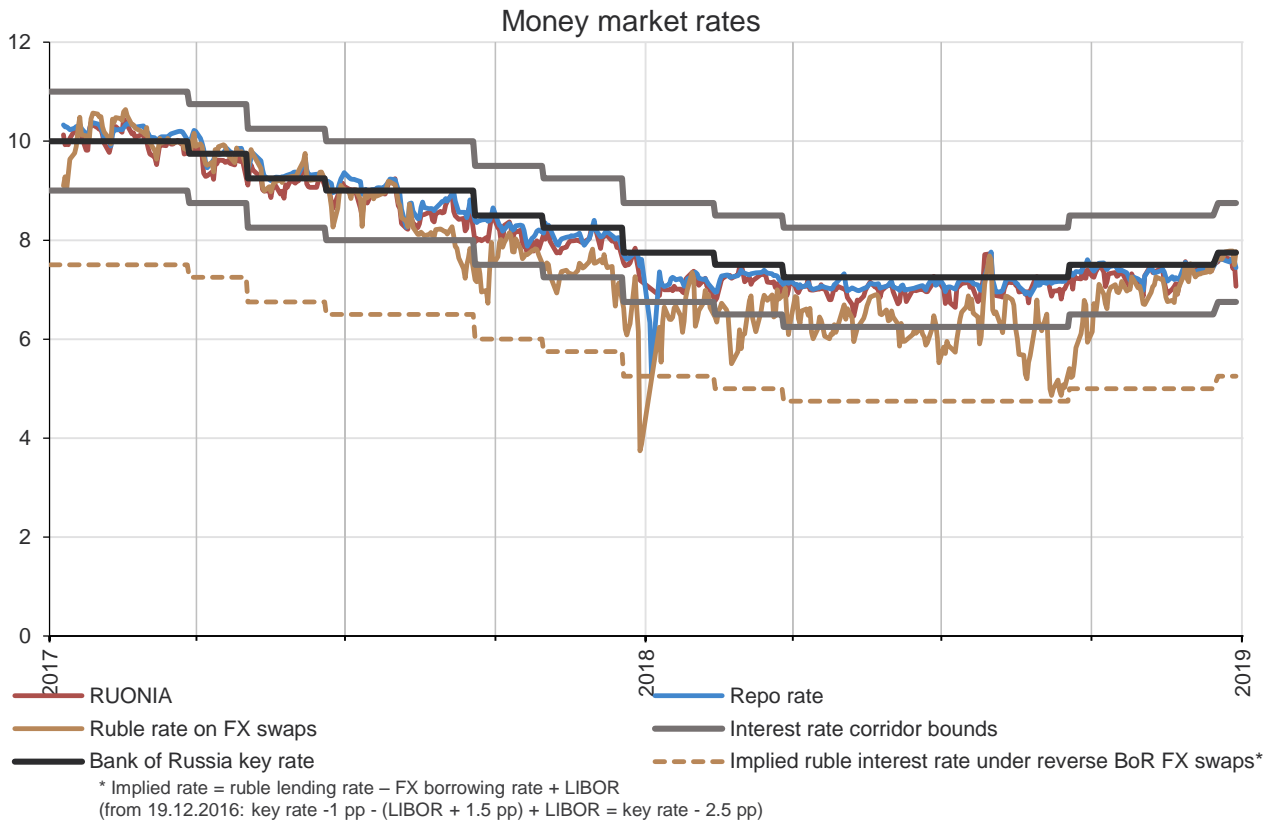
Spread between interbank rates and the Bank of Russia key rate shrank in the December averaging period



Source: Bank of Russia calculations.

Chart 3

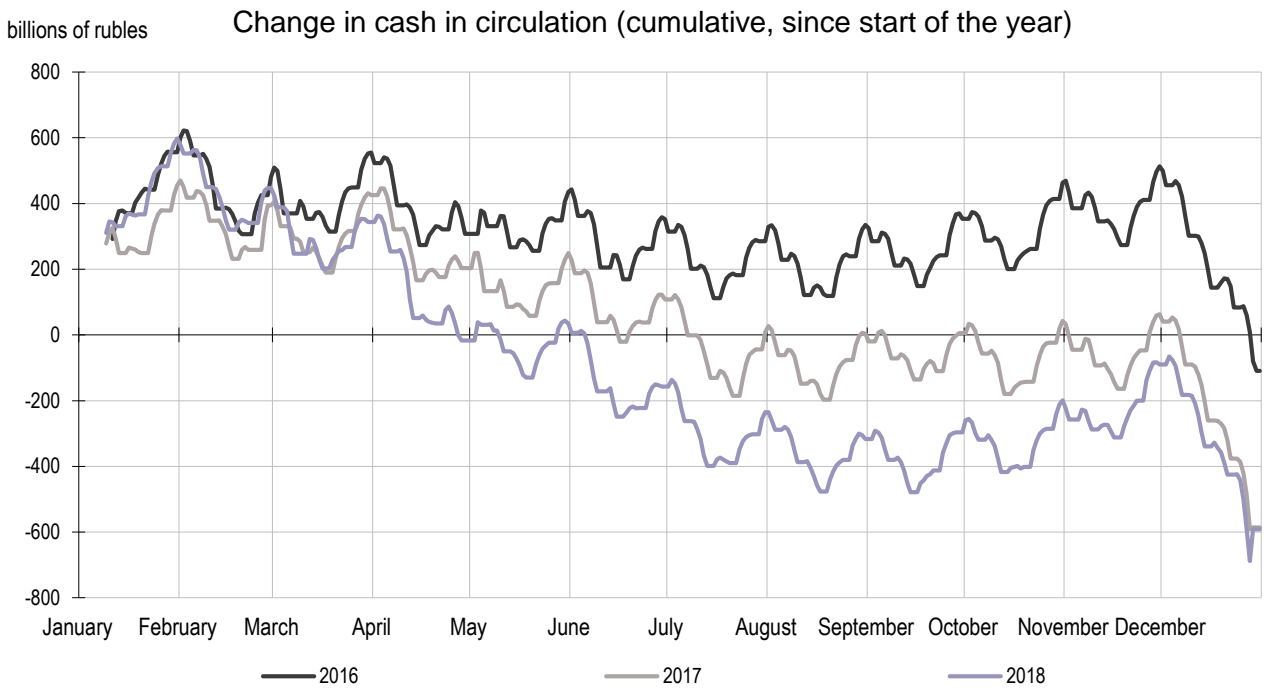
Money market rates were close to the Bank of Russia key rate



* 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)
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 (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

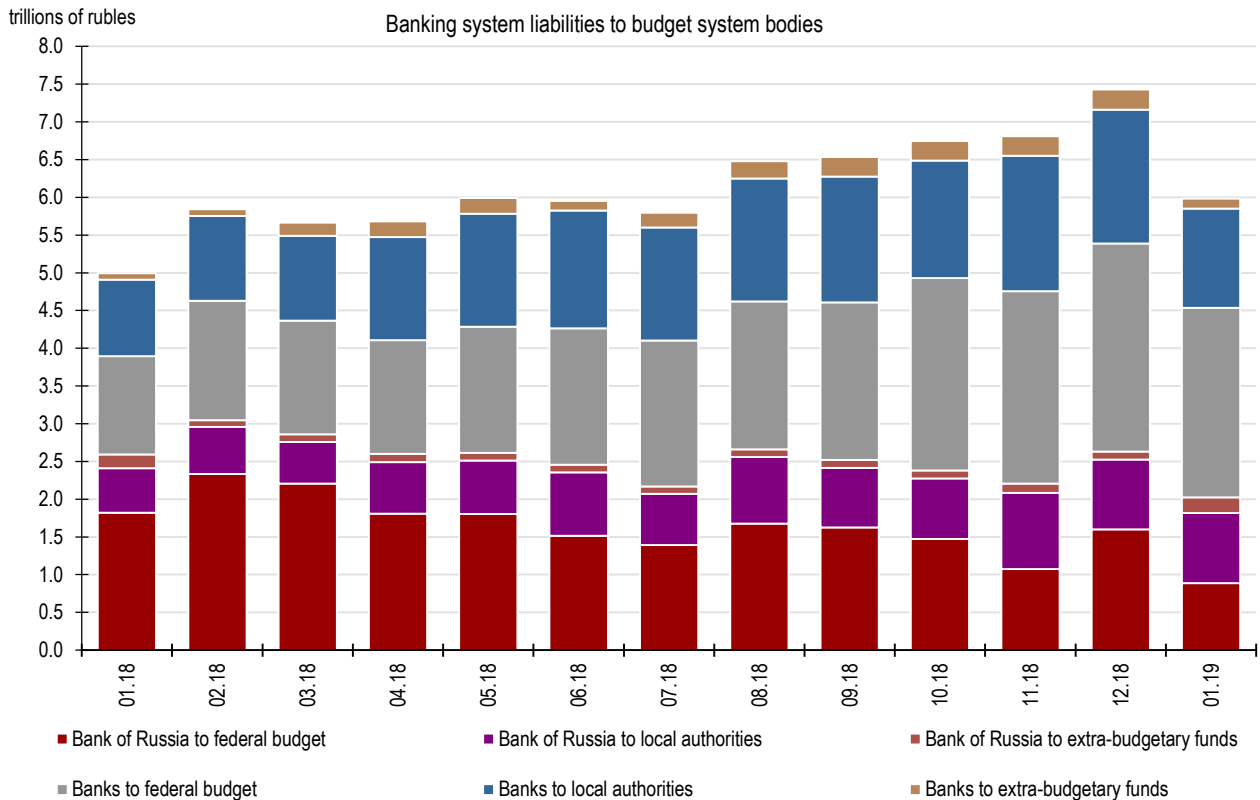
In December, cash in circulation was close to last year readings



Source: Bank of Russia calculations.

Chart 5

The Federal Treasury and budgets of Russian constituents reduced the volume of funds placed with banks in deposit and repo accounts, though to a lesser degree than expected by the Bank of Russia



Source: Bank of Russia calculations.

Table 3

In December 2018, the banking sector's structural liquidity surplus increased

(start of business, trillions of rubles)	01.01.2018	01.12.2018	01.01.2019
Structural liquidity deficit (+) / surplus (-)	-2.6	-2.7	-3.0
Bank of Russia standard monetary policy instruments			
Bank of Russia claims on credit institutions	0.0	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	0.0	0.4	0.0
- repos and FX swaps	0.0	0.0	0.0
- secured loans	0.0	0.3	0.0
Credit institutions' claims on the Bank of Russia	2.7	3.3	3.3
• Deposits	2.4	1.7	1.9
- auction-based	2.1	1.5	1.5
- fixed interest rate	0.2	0.2	0.4
• Bank of Russia bonds	0.4	1.6	1.4
Standing reverse facilities other than Bank of Russia standard monetary policy instruments*			
• Net claims of credit institutions and the Bank of Russia	0.1	0.3	0.3

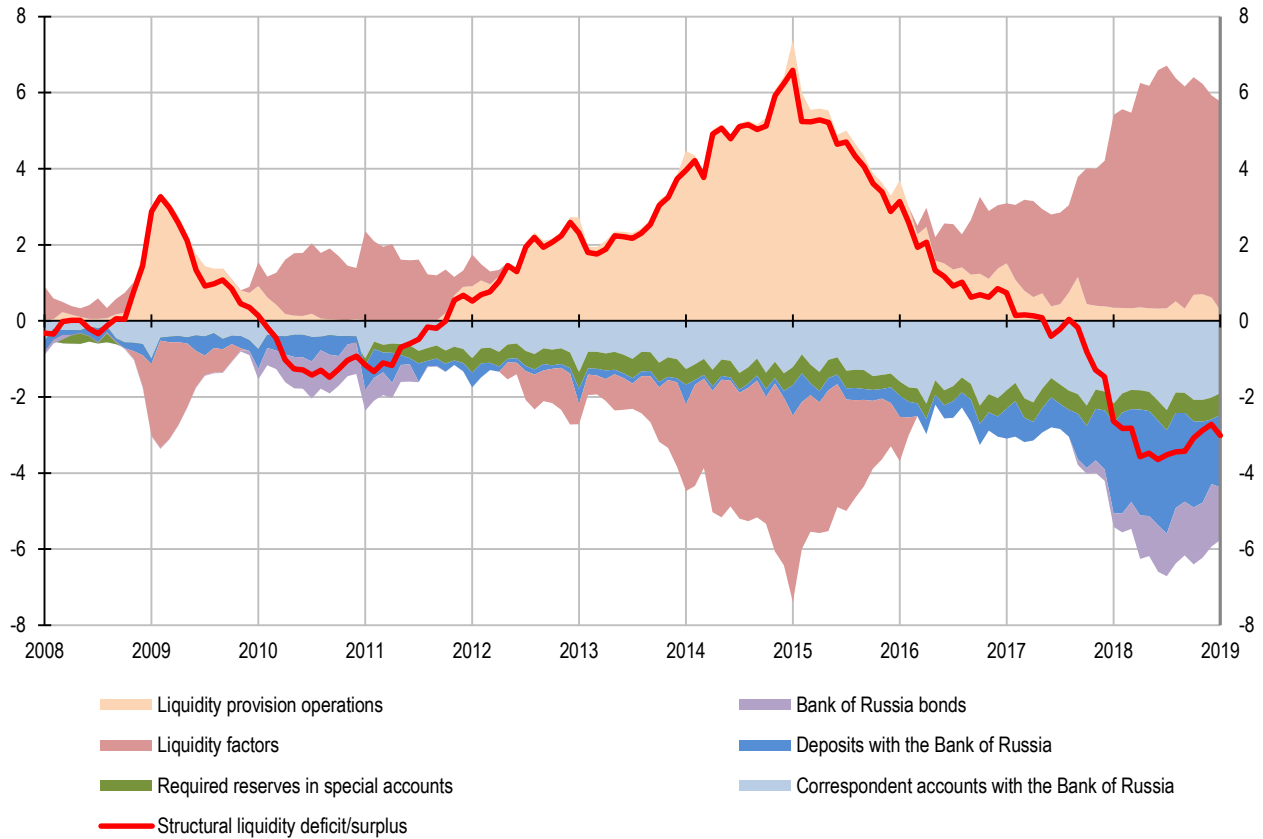
* These transactions include Bank of Russia specialised refinancing instruments, Bank of Russia loans issued under irrevocable credit lines, and USD/RUB and EUR/RUB sell/buy FX swaps.

Source: Bank of Russia calculations.

Chart 6

trillions of rubles

Bank of Russia balance sheet



Source: Bank of Russia calculations.

Foreign exchange and stock market

The situation in the Russian financial market remained relatively stable in December despite massive selling in the markets of most advanced economies. At the same time ruble depreciated considerably given global oil price downturn.

Foreign exchange rate. In the first half of December, the US dollar/ruble exchange rate was relatively stable, dropping though almost by 5% over the last two weeks. This was mainly linked to the global oil price downturn which dipped by 12% over the same period of time. Additionally, during this period large-value FX purchases were made by foreign investors which had slightly reduced their investment in OFZs and which might also reduce their long ruble positions on the New Year eve. Other EME currencies remained relatively stable during this period.

Country risk premium. In December, CDS spread for Russia fell by 13 bp, remaining virtually unchanged in the majority of other EMEs (on average, +1.5 bp). Drop in the premium is linked to its return to the average level observed in October before the surge of geopolitical tension. This

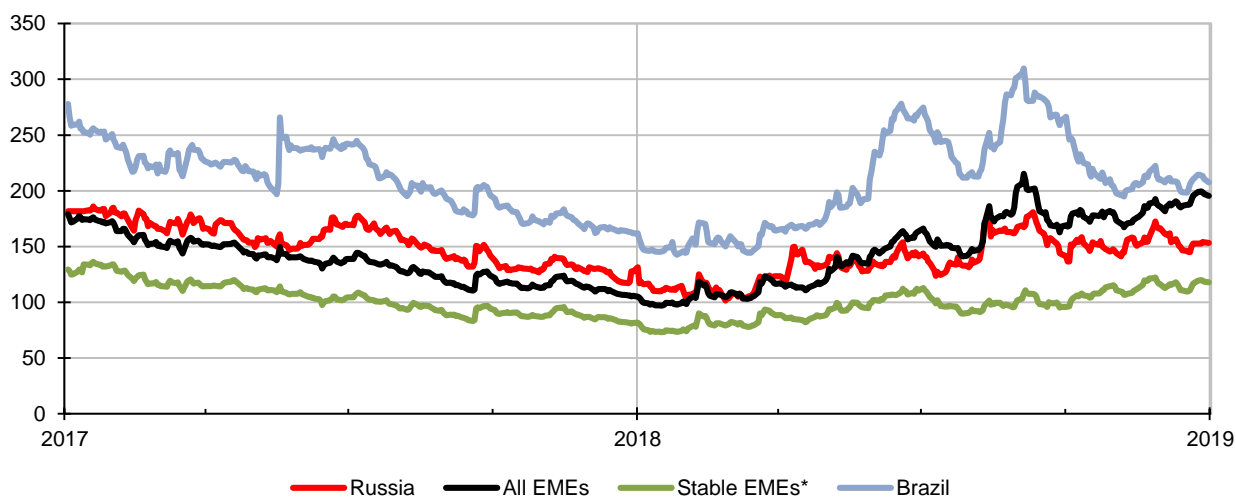
was explained by the absence of further escalation and information on a possible lift of the RUSAL sanctions.

OFZ. In December, the volume of OFZ sales by foreign investors stayed at the November level. However, in the first half of the month, the inflow of funds totalled 7.5 billion rubles which reversed by the end of December to a 13.1-billion-ruble drop in non-residents' investment in OFZs (according to the exchange data) due to oil price downturn and the ruble depreciation. Nonetheless, the short end of the OFZ yield curve shifted downwards by 25 bp.

Stocks. The MOEX Index for ruble fell by 1.0%, whereas due to the ruble weakening the MSCI Russia dollar index dipped more, i.e. by 4.0%. Overall, these dynamics keep in line with the movements in the global stock markets in December. The MSCI EM index, which reflects situation in EME stock markets, fell by 2.9% and the MSCI World index (advanced markets) fell by 7.7%. Additional negative drag for the Russian market came from the drop of global oil prices.

Chart 7

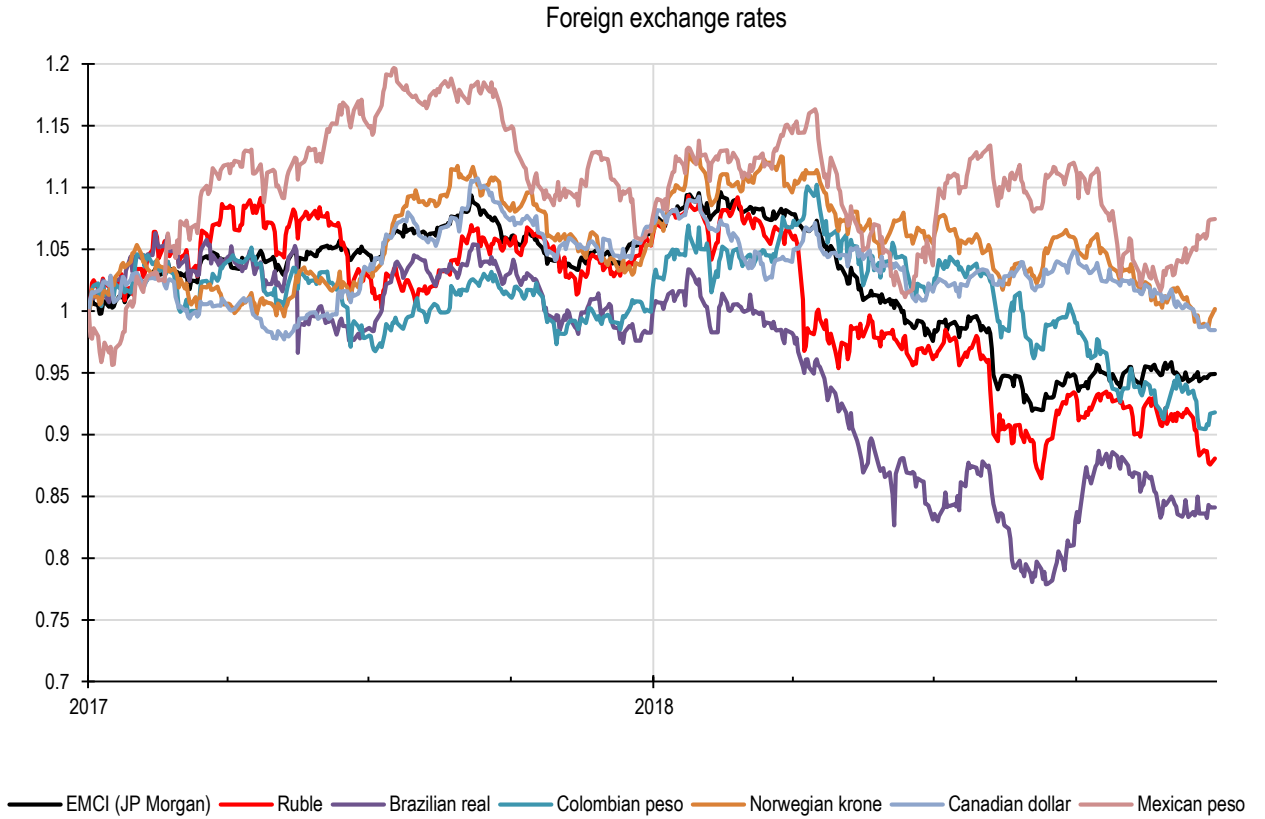
In December, CDS spread for Russia reduced, whereas it increased for the majority of other EMEs



* 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 8

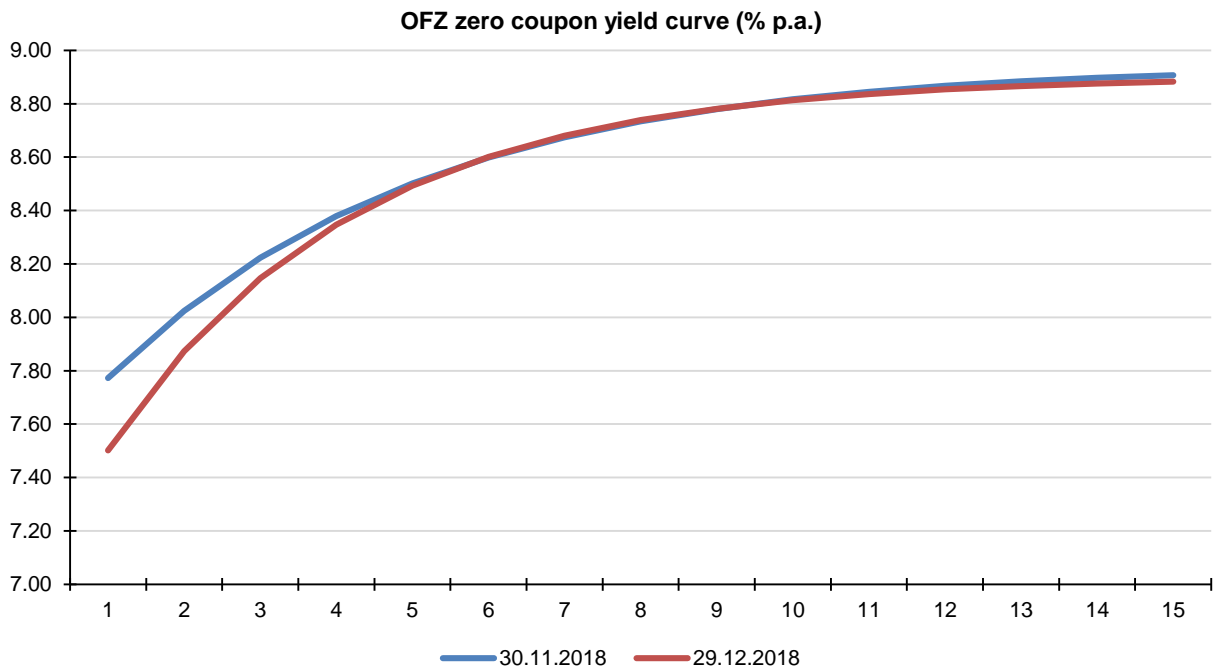
The ruble exchange rate dropped considerably at the end of the month



Sources: Bloomberg, Bank of Russia calculations.

Chart 9

OFZ zero coupon yield curve shifted downwards at the short end



Source: Moscow Exchange.

Chart 10

Russian stock indices declined in line with the global markets and oil prices

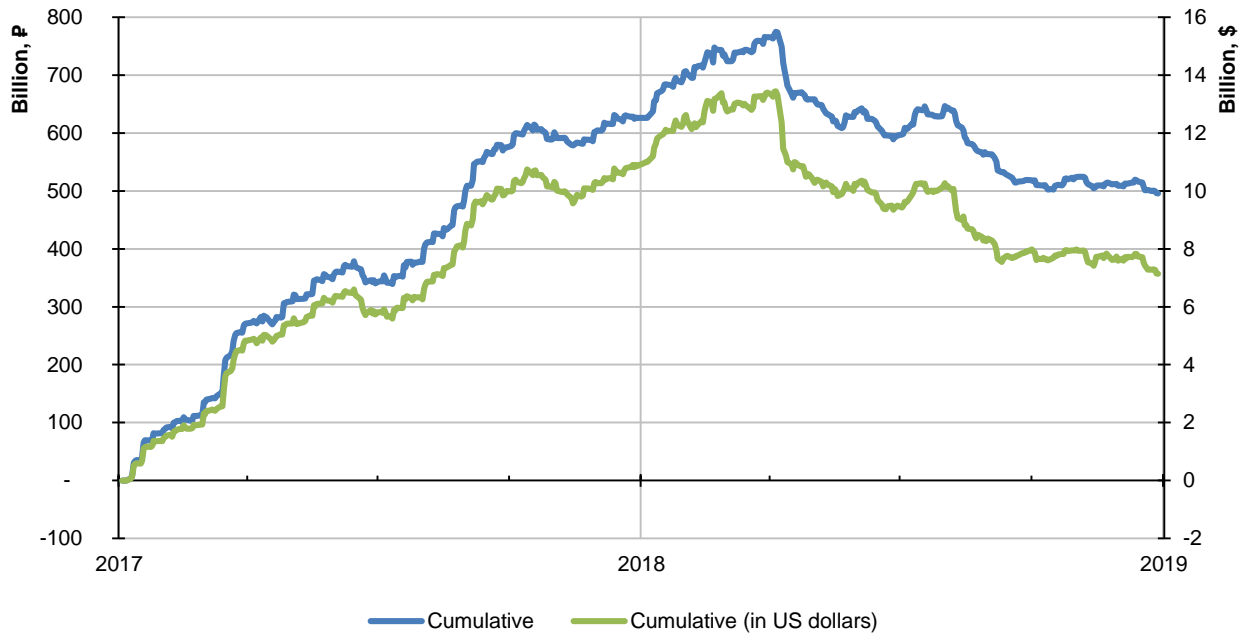


Sources: Bloomberg, Bank of Russia calculations.

Chart 11

In December, the outflow of non-residents' funds from the OFZ market remained moderate

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



Source: Bank of Russia calculations.

Most segments of the Russian market remained stable despite selling in global markets

Stock market indicators					
Segment	Indicator	As of 29.12.2018 COB*	Change**		Average 2017*
			monthly	monthly average	
Equity market	MICEX index	2,369.3	-1.0	-0.2	2,039.8
	RTS index	1,068.7	-5.1	-1.7	1,101.9
Bond market	OFZ	8.39	-5.0	-3.4	7.9
	Corporate bonds	9.14	16.0	13.4	8.9
	Regional bonds	8.5	-19.0	7.0	8.5
Foreign market	Russia-43	5.45	-14.4	-10.5	4.9
	UST-10.	2.72	-26.9	-27.7	2.3
Risk appetite indicators	RVI	27.0	0.4	0.0	21.3
	EMBI+ Russia	242.0	13.0	12.6	145.1
	EMBI+ EM	440.6	11.5	16.4	326.6
	CDS	153.8	-12.6	-3.1	156.0

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

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

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

Credit and deposit market

At end-November 2018, **interest rates in the key market segments of household deposits and corporate loans grew by 0.1-0.3 pp, thereby slightly outrunning growth in the yield of government bonds with comparable maturities** (Chart 13), which is in part explained by a faster increase in the yield of government bonds in previous months. **The household lending segment saw a resumed drop in interest rates** which is explained both by higher interest rates (and a respective potential for their reduction) in this market segment and competition for more reliable retail borrowers between banks, and an increase in the proportion of mortgage loans in the market turnover.

In December, interest rates on medium- and long-term instruments of the debt and money markets grew weakly, demonstrating reduction across individual segments, which suggests a potential slowdown in interest rate growth for banking operations. According to preliminary data, in December banks increased deposit rates less actively compared to the previous month: growth in interest rates was mainly registered for seasonal special offers on short- and medium-term deposits.

Deposit market. In November 2018, amid the nominal ruble depreciation there was an inflow of funds to household foreign currency deposits, whereas ruble deposits shrank slightly, thereby leading to an increase in the share of foreign currency deposits (Chart 14). The conversion of funds into foreign currency deposits observed in November was of transitory nature. According to preliminary data, depositors' interest in ruble deposits recovered in Decem-

ber: the December inflow of funds to time ruble deposits tripled the same reading for foreign currency deposits.

Credit market. In November, growth in lending to the economy was ensured by operations in the retail segment of the market, with the corporate credit portfolio remaining virtually unchanged by the end of the month. As a result, the annual growth of household lending grew amid a modest slowdown in the growth of corporate lending (Chart 15). According to preliminary estimates, in December the main contribution to the increase in lending to the economy also came from the retail segment of the market.

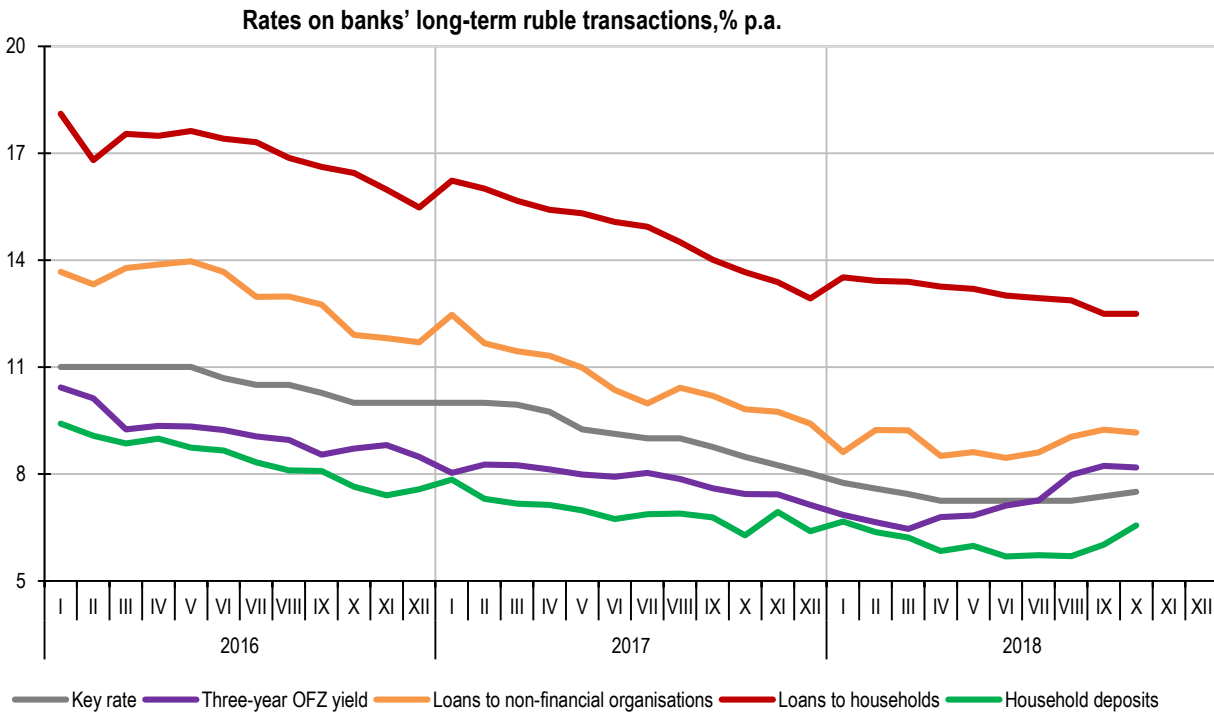
In November, more than a half of increase in the household loan portfolio came from mortgage loans in the retail segment (Chart 16). This constitutes a noticeable change compared to previous months, when the main contribution to increase in household lending was made by consumer lending.

Banks' financial performance. At end-November, the share of overdue debt in the loan portfolio dropped both in the household and in the corporate segments of the market (Chart 15). The improvement in the quality of banks' loan portfolio coupled with the ongoing growth of bank assets boosted bank profits. At the end of the month, the profit of the Russian banking sector came in at roughly 100 billion rubles. According to preliminary estimates for 2018, the profit of the banking sector reached 1.3 trillion rubles (vs 0.8 trillion rubles in 2017¹). Growing profits earned by banks helped to build up their capital (both by directly increasing their capital and by improving the investment appeal of the banking sector), which in turn sets the ground for further build-up of banking assets and their diversification.

¹ The profit measures for November and for 2017 are adjusted because of the technical error made in the first version of the issue.

Chart 12

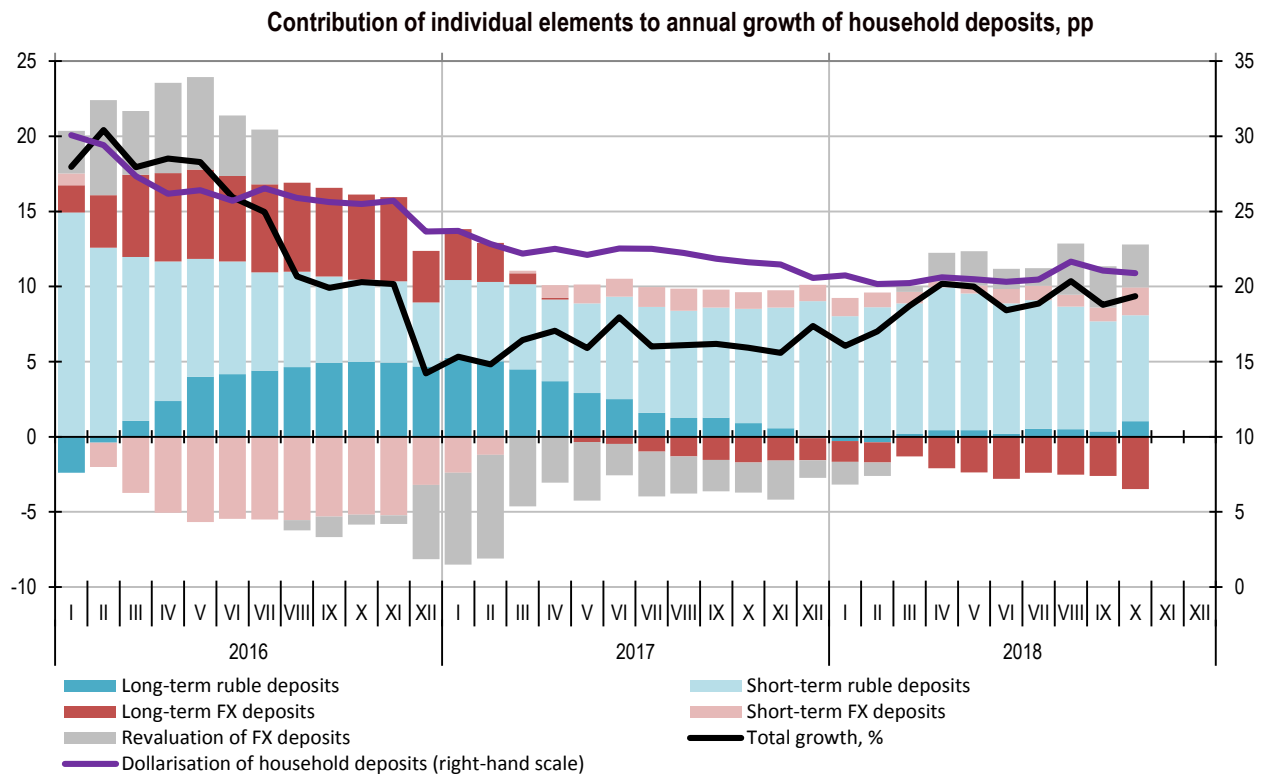
November saw an increase in interest rates on household deposits and corporate loans, interest rates decreased in the household lending segment



Source: Bank of Russia.

Chart 13

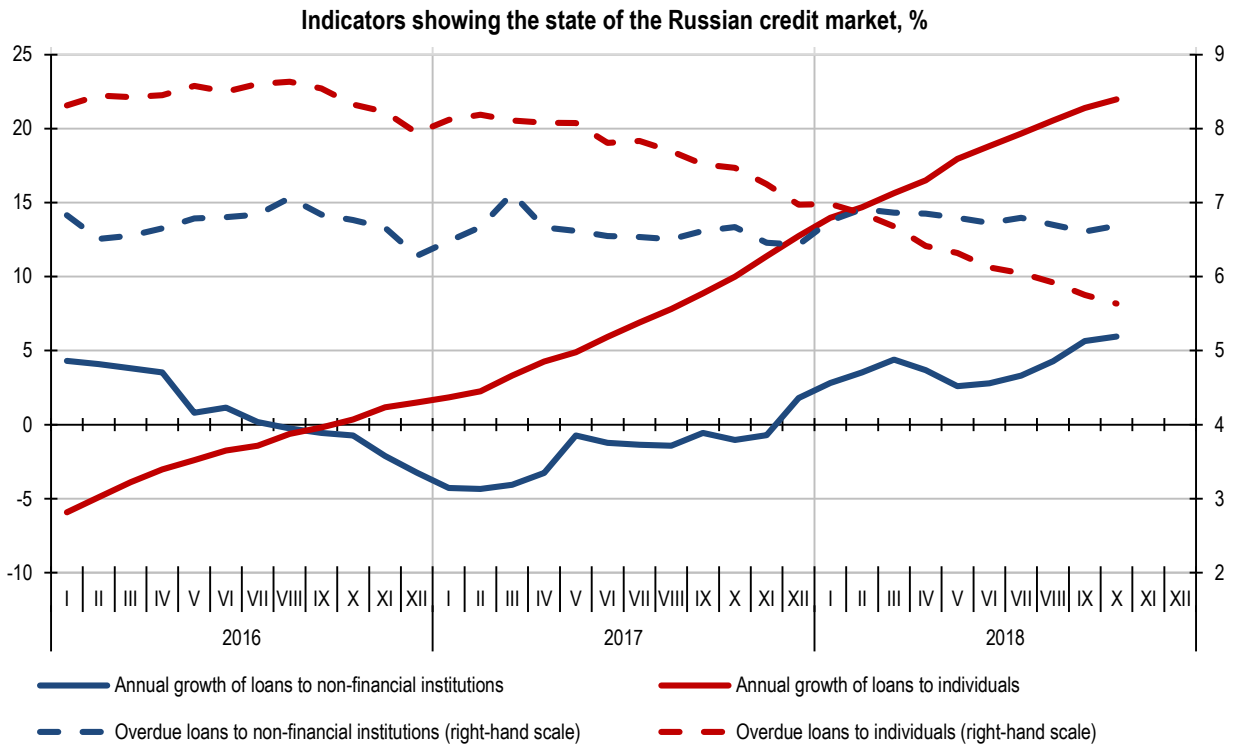
In November, the proportion of foreign currency deposits in the total household deposits was close to the level of past months



Source: Bank of Russia calculations.

Chart 14

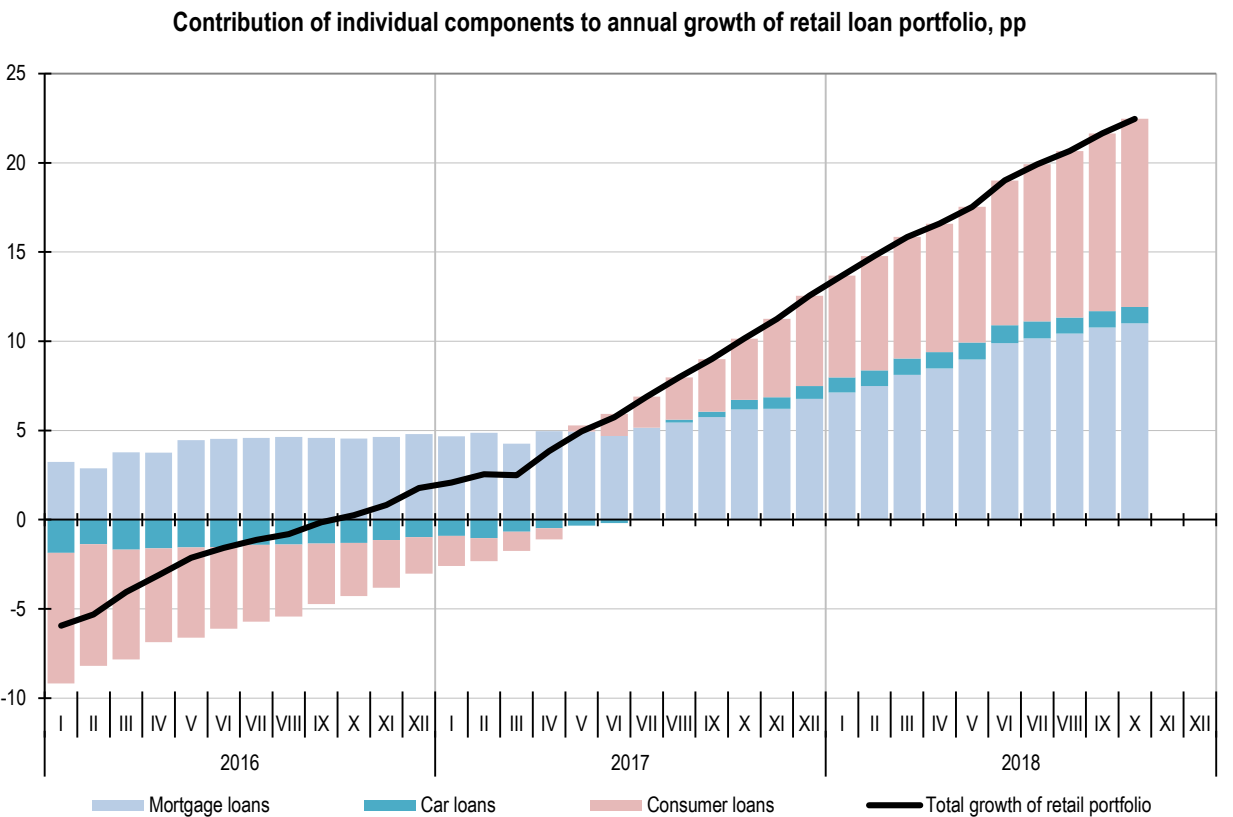
Household lending continued to grow fast amid improved quality of household loan portfolio



Source: Bank of Russia calculations.

Chart 15

November saw a faster growth in mortgage lending compared to consumer lending

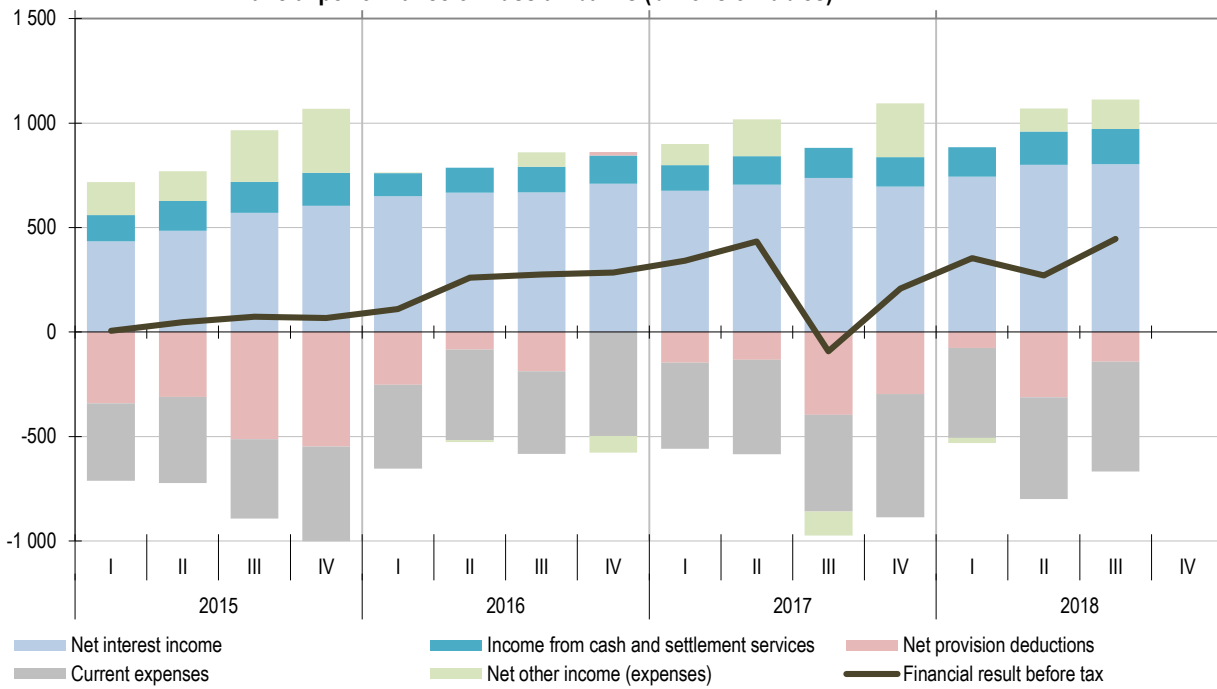


Source: Bank of Russia calculations.

Chart 16

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)

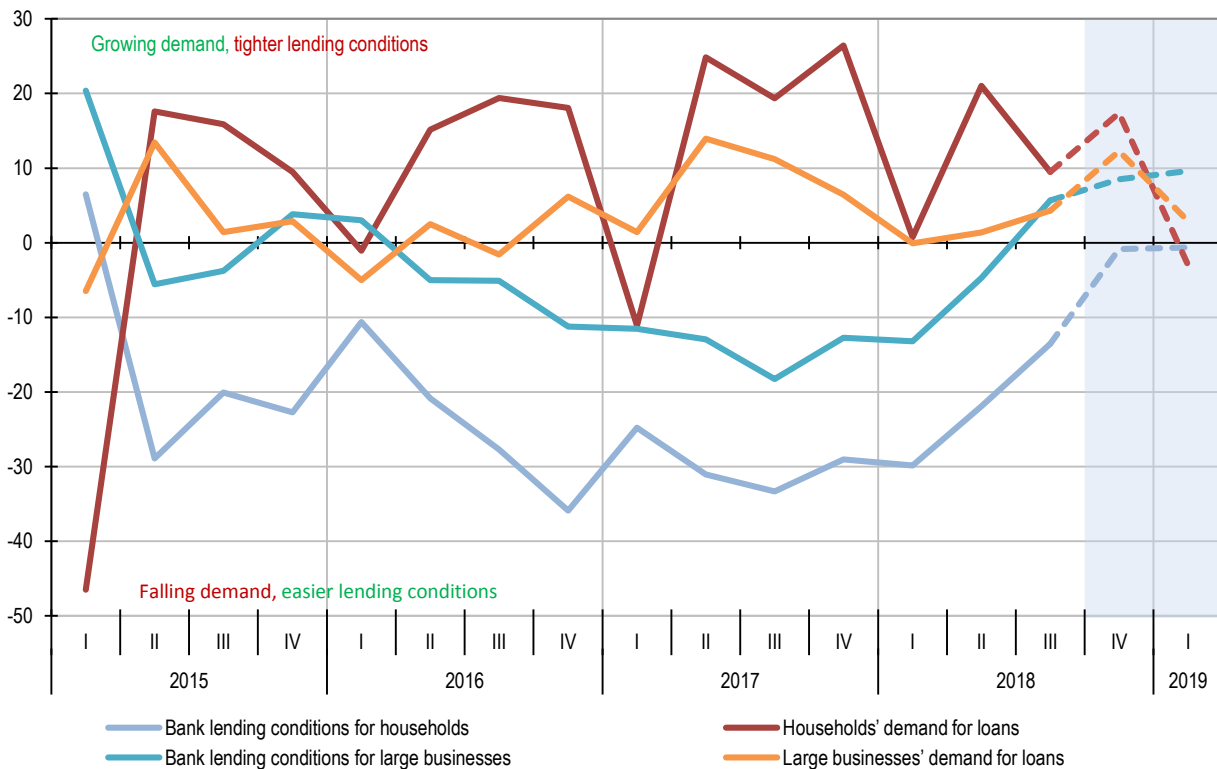


Source: Bank of Russia.

Chart 17

Demand for loans continued to rise in 2018

Lending conditions and demand for loans indices, pp



Source: Bank of Russia calculations.