



Bank of Russia

No. 1

**BANK OF RUSSIA FOREIGN
EXCHANGE AND GOLD
ASSET MANAGEMENT REPORT**

Moscow
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This publication has been prepared by the Market Operation Department.
The reference to the Central Bank of the Russian Federation is mandatory if you intend to use
information from this review.

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FOREWORD

This issue of the Bank of Russia Foreign Exchange and Gold Asset Management Report presents the results of asset management in July 2019 – June 2020.

Due to global financial markets' high price sensitivity to the actions of major market participants, including the Bank of Russia, data on Bank of Russia operations on foreign exchange and gold asset management are published at least six months after the end of the reporting period.

Information on Bank of Russia assets is also published in the Bank of Russia Annual Report (managing assets in foreign currency and precious metals) and on the Bank of Russia website (data on Russia's international reserves). Please note that any difference in the data provided between the reports is due to data composition and calculation methodologies only.

Terms shown in the text in italics are defined in the glossary.

Please send any feedback, including comments and suggestions regarding the contents of the report and data presentation to reservesmanagement@mail.cbr.ru.

1. PRINCIPLES OF FOREIGN EXCHANGE AND GOLD ASSET MANAGEMENT AND FINANCIAL RISK MANAGEMENT

The Bank of Russia's foreign exchange assets include government and non-government bonds of foreign issuers, deposits and nostro accounts balances, *reverse repo* operations, Russia's net position with the IMF, Russian sovereign Eurobonds and other claims on counterparties. These assets are denominated in US dollars, euros, pounds sterling, Canadian and Australian dollars, Swiss francs, yen, yuans and *Special Drawing Rights* (SDR) (hereinafter, foreign currencies). Foreign securities purchased by the Bank of Russia through reverse repo transactions are excluded from the total volume of foreign exchange assets.

The objective of foreign exchange asset management is to ensure the best balance between the safety, liquidity and profitability of assets.

Bank of Russia assets in precious metals are managed separately from foreign exchange assets. Bank of Russia gold assets comprise monetary gold, stored at vaults within the territory of the Russian Federation.

Foreign exchange assets, liabilities and claims on unsettled transactions in foreign currencies are grouped into single-currency portfolios. To assess the efficiency of the management of single-currency portfolios their returns are compared to *benchmark portfolio* returns. The rate of return on Bank of Russia single-currency portfolios was calculated as the total (realised and unrealised) return on investments in assets of the corresponding portfolio as a percentage per annum.

Foreign exchange asset management takes into account the Bank of Russia's liabilities in foreign currencies (balances on foreign currency accounts of clients, mainly *the National Wealth Fund*) and other Federal Treasury assets earmarked for crediting to the National Wealth Fund. Foreign currency holdings expose the Bank of Russia to financial risks, such as credit risk, foreign exchange risk, interest rate risk and liquidity risk. The risk management process

while conducting operations with foreign currency assets of the Bank of Russia includes the identification of risks, risk assessment, the setting of risk limits, and monitoring compliance with the limits. Under asset management decision making process the Bank of Russia takes into account both financial risks and non-financial risks.

Credit risk means the risk of counterparties or issuers defaulting on their obligations to the Bank of Russia. Credit risk is constrained by various limits and requirements for the credit quality of counterparties and issuers, which must have a minimum *credit rating* of A under the Fitch Ratings and S&P Global Ratings classifications and a minimum rating of A2 under the Moody's Investors Service classification.

Foreign exchange risk means the probability of a decrease in the value of net foreign currency assets (assets net of liabilities) due to foreign currency exchange rate movements. The Bank of Russia limits the level of foreign exchange risk by specifying a benchmark currency structure of net foreign exchange assets with target weights or amounts of eligible currencies and the limits of their deviations.

Interest rate risk is the probability of a decrease in the value of foreign exchange assets due to any unfavourable changes in interest rates. The level of interest rate risk for the Bank of Russia's assets portfolios is measured by *duration*. The interest rate risk exposure is limited by setting the minimum and maximum durations allowed in each of the eligible currency portfolios. Additionally, the maturities of eligible securities, deposits and repo operations are limited.

Liquidity risk means the risk of losses due to insufficient funds to cover Bank of Russia current liabilities in foreign currencies. In order to lower this risk, the volume of liquid assets in each currency is maintained at a level exceeding the volume of liabilities in the same currency. The most liquid assets are government securities, which are the major component of

foreign exchange assets. Sources of liquidity also include nostro account balances, credit lines, short-term deposits and repo operations, as well as cash inflows from coupon payments and redemptions of securities denominated in foreign currencies. The amounts of funds that can be accumulated by the Bank of Russia through the use of liquid assets and additional sources of liquidity exceed the amount of liabilities on execution of which these funds can be spent during a certain period.

Under bank account agreements with the Federal Treasury, the Bank of Russia accrues and pays interest on the balances of foreign currency accounts of the National Wealth Fund, based on the rate of return on indices composed of foreign countries' bonds with specific shares in the index. The set of foreign government bonds included in the index is established by the Federal Treasury and revised regularly in compliance with the procedure set forth in the agreements. The Bank of Russia accrues interest on the cash balance in foreign currency accounts of the Federal Treasury earmarked for

crediting to the National Wealth Fund based on money market rates in the respective currency. The Bank of Russia makes interest payments on the balance of the National Wealth Fund in rubles. Since the Bank of Russia has the right to issue currency, these obligations don't expose it to interest rate and liquidity risks.

The Bank of Russia has a multilevel collective system for investment decision-making. The Bank of Russia Board of Directors sets the objectives of foreign exchange asset management, the list of eligible investment instruments, and the target level of foreign exchange risk.

The Bank of Russia collective body, which is in charge of investment strategy and which reports to the Board of Directors, sets the levels of interest rate and credit risks and approves the lists of eligible counterparties and issuers.

The adopted investment decisions are implemented by the authorised divisions of the Bank of Russia. External managers are not involved in foreign exchange and gold asset management.

2. FOREIGN EXCHANGE AND GOLD ASSET MANAGEMENT IN JULY 2019 – JUNE 2020

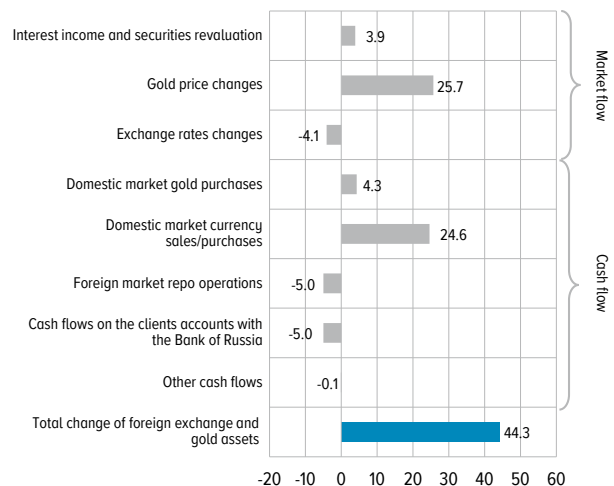
In the period under review, Bank of Russia foreign exchange and gold assets increased by \$44.3 billion to reach \$561.1 billion (Table 1). Among the main drivers of the increase were foreign currency purchases (Charts 1) carried out as part of the Federal Treasury's foreign currency acquisitions from the Bank of Russia under the fiscal rule implementation. Gold price growth and gold purchases from Russian credit organisations as well as gold usage in minting of precious metal coins were other factors of the change in the value of assets. The value change was additionally influenced by client funds outflow from the accounts with the Bank of Russia, the decrease in the amount of repo operations with foreign counterparties of the Bank of Russia as of the reporting date and changes in the foreign exchange rates against the US dollar. These repos are mainly conducted to raise funds under repo operations and simultaneously invest the funds with foreign counterparties in the corresponding amount at a higher rate on deposits, reverse repo or nostro accounts with a correspondent bank.

In July 2019 – June 2020, portfolios of securities of foreign issuers (including foreign

governments and international organisations) expanded (Table 1). The amount of deposits and nostro account balances with foreign counterparties decreased.

As of 30 June 2020, the category 'Others' in Chart 2 includes assets in yen (3.9%), the Canadian (2.5%) and Australian (0.8%) dollars. The balance of accounts in Swiss francs was negligible. The SDR-denominated net claims of

CHANGES IN FOREIGN EXCHANGE AND GOLD ASSETS *Chart 1*
IN JULY 2019 – JUNE 2020
(BILLIONS OF US DOLLARS)



FOREIGN EXCHANGE AND GOLD ASSETS BY ASSET CLASS

Table 1

Assets	As of 30 June 2019		As of 30 June 2020		Change in July 2019 – June 2020, billions of US dollars
	billions of US dollars	share of assets	billions of US dollars	share of assets	
Government securities of foreign issuers*	206.2	39.9	218.3	38.9	12.1
Deposits and account balances with foreign counterparties	147.5	28.5	138.8	24.7	-8.7
Gold	98.7	19.1	128.5	22.9	29.9
Non-government securities of foreign issuers	36.4	7.0	45.8	8.2	9.4
International organisations securities	15.8	3.1	23.5	4.2	7.7
Net position with the IMF	2.6	0.5	3.6	0.6	1.1
Claims in foreign currency on Russian counterparties and issuers**	2.7	0.5	1.4	0.2	-1.3
Reverse repo operations with foreign counterparties	7.2	1.4	1.0	0.2	-6.2
FX transactions claims on foreign counterparties	-0.1	0.0	0.2	0.0	0.3
Total***	516.8	100.0	561.1	100.0	44.3

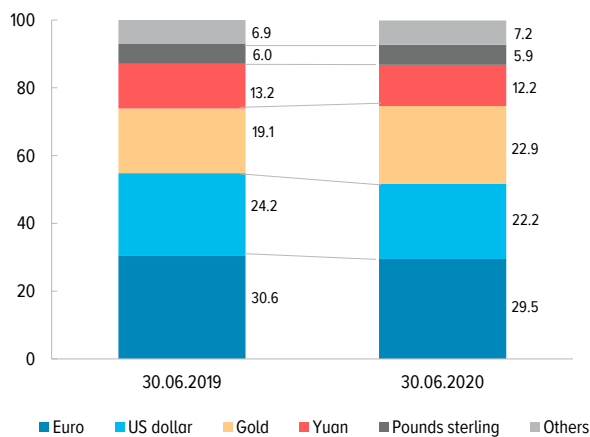
* Securities issued by a foreign government or foreign issuers with explicit government guarantee.

** Claims on Russian credit institutions, Eurobonds of the Russian Federation and other Russian issuers.

*** The total value may differ from the sum of asset classes values due to rounding.

BANK OF RUSSIA FOREIGN EXCHANGE AND GOLD ASSETS BY CURRENCY*
(% OF MARKET VALUE)

Chart 2



* The distribution takes into account unsettled conversion transactions as of 30 June 2019 and 30 June 2020

the Russian Federation on the IMF are accounted for in the breakdown in the proportions determined by the IMF for calculating the SDR value.

Chart 3 shows the geographical structure of assets by place of residence of counterparties or issuers of securities.

Asset distribution in Chart 4 is based on the lowest of the credit ratings assigned by any of the three rating agencies (Fitch Ratings, S&P Global Ratings and Moody's Investors Service).

Data on the return on the actual and benchmark single-currency portfolios of Bank of Russia foreign exchange assets are shown in Table 2.

GEOGRAPHICAL DISTRIBUTION OF BANK OF RUSSIA FOREIGN EXCHANGE AND GOLD ASSETS
(%)

Chart 3

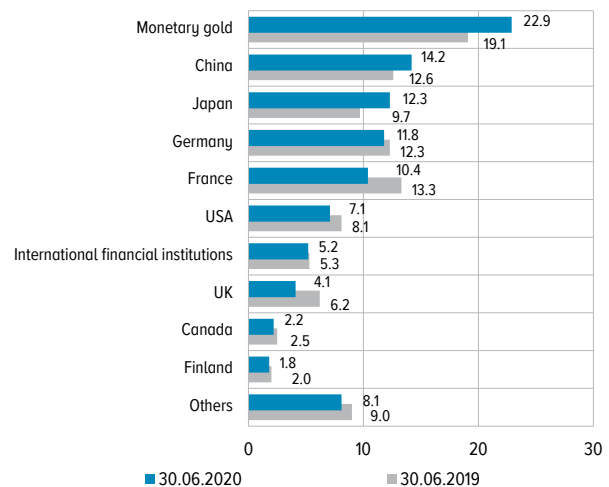
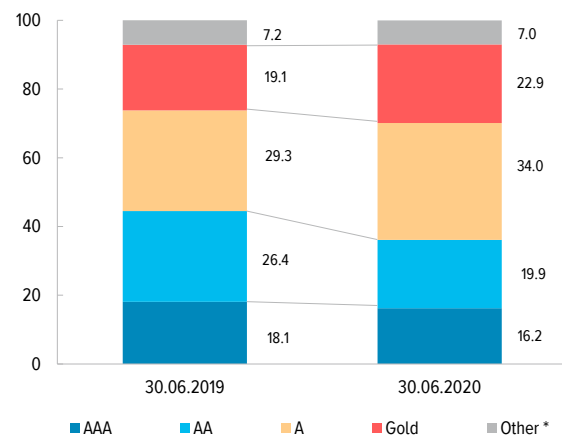
**BANK OF RUSSIA FOREIGN EXCHANGE AND GOLD ASSETS BY CREDIT RATING**
(%)

Chart 4



* Mainly claims on Russian counterparties and issuers and Russia's net position with the IMF.

RETURN ON BANK OF RUSSIA FOREIGN EXCHANGE ASSETS* IN JULY 2019 – JUNE 2020
(% P.A.)

Table 2

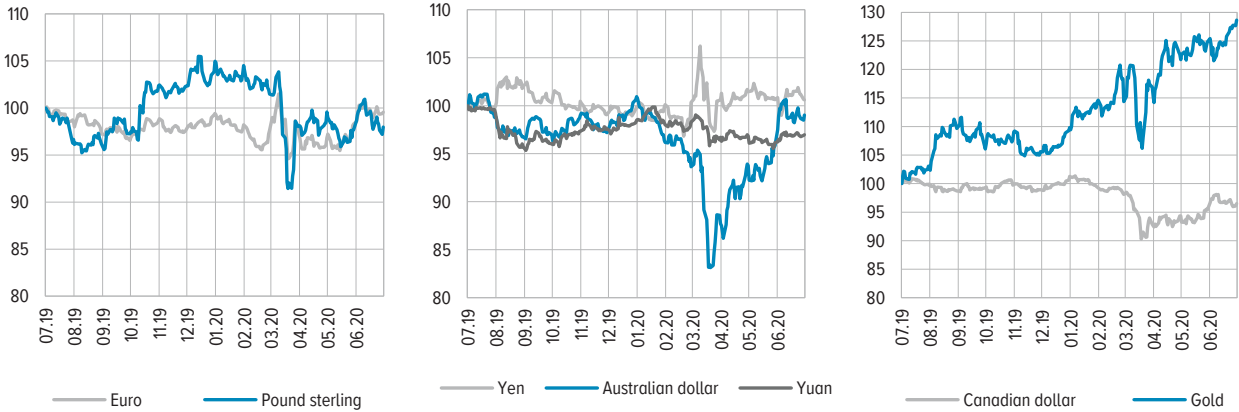
Indicator	US dollar	Euro	Pound sterling	Canadian dollar	Australian dollar	Yuan	Yen
Return on actual single-currency portfolios of foreign exchange assets	1.31	-0.48	1.07	2.54	1.53	3.45	0.04
Return on benchmark single-currency portfolios of foreign exchange assets	0.94	-0.70	0.89	2.40	1.28	3.34	-0.11

* The term is defined in the glossary.

ANNEX

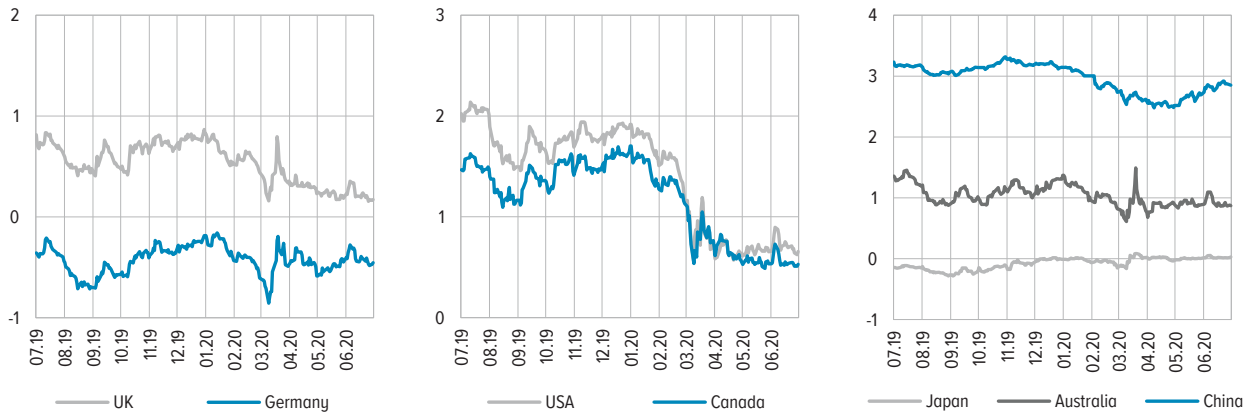
CHANGES IN EXCHANGE RATES AND GOLD PRICE AGAINST THE US DOLLAR (% AS OF BEGINNING OF THE PERIOD)

Chart 1



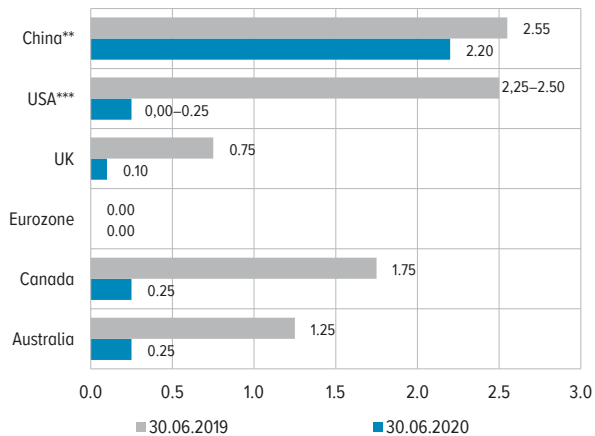
YIELDS TO MATURITY ON 10-YEAR GOVERNMENT BONDS (% P.A.)

Chart 2



CENTRAL BANKS KEY RATES* (% P.A.)

Chart 3



* The term is defined in the glossary.

** The PBOC's 7-day reverse repo rate.

*** The Federal Open Market Committee establishes the target range for the federal funds rate.

GLOSSARY

Benchmark portfolio	<i>A set of financial instruments in each reserve currency taken in appropriate percentage. Benchmark portfolios reflect the target distribution of Bank of Russia assets in each foreign currency</i>
Central bank key rate	<p><i>A rate set by a central bank to impact interest rates in the economy. Usually, a change to the key rate is a major monetary policy tool</i></p> <p><i>Examples of key rates used by the leading central banks include:</i></p> <ul style="list-style-type: none"> • <i>US Federal Reserve System (Fed) – A target for an interest rate at which depository institutions lend reserve balances to other depository institutions overnight;</i> • <i>European Central Bank (ECB) – A minimum rate at ECB repo auctions;</i> • <i>Bank of England – An interest rate on commercial bank reserves deposited with the Bank of England;</i> • <i>Bank of Canada – A target for an interbank loan rate;</i> • <i>Reserve Bank of Australia – A target for an interbank loan rate;</i> • <i>Bank of Japan (BoJ) – BoJ is targeting an annual amount of asset purchases (since 2013), the level of 10-year JGB yields (since 2016) and is applying a negative interest rate to the reserves of financial institutions held in BoJ accounts (since 2016).</i> • <i>The People’s Bank of China (PBOC) – Since the objective of the PBOC monetary policy is to maintain the stability of the value of the currency and thereby promote economic growth, the PBOC does not use single interest rate as a key rate. However the following two rates on the liquidity-providing operations are perceived by the market to be indicators of monetary policy stance: the 7-day reverse repo rate and the rate of MLF (Medium-Term Lending Facility, the 1-year loans provided by the PBOC to banks)</i>
Credit rating	<i>A rating agency’s assessment of the creditworthiness of a borrower and its ability to fulfill its financial obligations</i>
Currency swap	<i>An agreement pursuant to which counterparties exchange payments in different currencies. The Bank of Russia enters into currency swap operations in order to supply Russian credit institutions with ruble funds using foreign currency funds as collateral</i>
Duration	<i>A measure of the relative sensitivity of the value of a fixed-income instrument or a class of instruments to changes in the corresponding interest rates by one percentage point</i>
National Wealth Fund	<i>The National Wealth Fund of the Russian Federation including its foreign currency funds deposited with the Bank of Russia (in US dollars, euros and pounds sterling)</i>
Repo (reverse repo) transactions	<i>Securities sale (purchase) transactions with an obligation of their repurchase (resale) at future date at a stated price. These are mainly executed to borrow money and to simultaneously place corresponding amounts of money at higher interest rates</i>
Return on Bank of Russia foreign exchange assets	<i>The holding period return is calculated using chain index based on a daily return. Daily return on a single-currency portfolio is calculated as the ratio of aggregate (realised and unrealised) gain on the portfolio to its market value as of the end of the previous day</i>
SDR (Special Drawing Rights)	<i>An international reserve asset created by the IMF to supplement the existing official reserves of member countries. It is a potential claim on the freely usable currencies of IMF members. The SDR rate is determined based on the dollar value of a five-currency basket made up of the US dollar, euro, yen, pound sterling and yuan (from 1 October 2016)</i>