Bank of Russia

JANUARY 2019

BANKING SECTOR LIQUIDITY AND FINANCIAL MARKETS

Information and analytical commentary

Moscow
2019

Banking sector liquidity and financial markets: facts, assessments and comments (January 2019)

- *In January, the structural liquidity surplus decreased to 2.7 trillion rubles amid the outflow of funds via the budget channel.*
- *Short-term interbank lending rates held close to the Bank of Russia key rate. The average spread stood at -15 bp (vs -23 bp in 2018 Q4).*
- *The FX liquidity position remained favourable. The resumed fiscal rule-based purchases of foreign currency had no major implications for either FX liquidity or ruble exchange rate movements.*
- *Russian financial markets were on a much surer footing in January. Investor sentiment gained a boost from softening US Fed rhetoric over forthcoming monetary policy tightening, as well as the advances in US-China trade talks and the performance of oil prices, with Brent upwards of $60 per barrel.*
- *Household deposits continued to grow in December 2018 and January 2019 as the rise in deposit rates proved sustained.*
- *Banks' lending to the economy continued to expand, with the retail market segment maintaining its outpacing growth.*

BANKING SECTOR LIQUIDITY AND MONEY MARKET

Ruble liquidity. In January, the structural liquidity surplus decreased to 2.7 trillion rubles. The outflow of funds was largely due to major tax payments by banks' customers amid seasonally low budget expenditures. This led to growth in balances of budget funds placed with the Bank of Russia. Moreover, the volume of deposits of the Pension Fund of the Russian Federation placed with credit institutions went down. Liquidity outflow was partially offset by the return of cash funds to banks after the New Year holidays, first of all corporate cash earnings, banks' growing outstanding amounts under Federal Treasury deposits and repos, and the resumed purchases of foreign currency by the Bank of Russia in the domestic market under the fiscal rule implementation.

Money market. Short-term rates in the money market were close to the Bank of Russia key rate, with a slightly negative spread of -15 bp (ranging from the minimum of -25 bp to the maximum of 3 bp). Banks averaged their required reserves in advance and faster than in previous periods. Although all issues of coupon bonds were placed in full in January, demand for Bank of Russia deposits remained low at the beginning of the averaging period. This, however, did not affect interest rates, since excess funds were kept in correspondent accounts with the Bank of Russia rather than placed in the money market. In the last few days of January, liquidity outflow from banks due to the payment of taxes by their customers was traditionally conducive to rate growth. By the end of the required reserve averaging period, banks' demand for liquidity had decreased and the negative spread of money market rates to the Bank of Russia key rate slightly expanded. To mop up excess liquidity the Bank of Russia held two fine-tuning deposit auctions on 4 and 5 February, where it raised 1,300 and 1,348 billion rubles respectively.

FX liquidity. The short-term interest rate spread in the interbank and FX swap segments remained close to zero on the back of FX liquidity improvements in the banking sector. The resumed fiscal rule-based purchases of foreign currency had no major implications for either the cost of foreign currency borrowings in the FX swap segment in January or ruble exchange rate movements. Major banks continued to increase their FX liabilities due to the inflow of customer deposits and exporter-servicing banks to expand foreign currency placement in the FX swap segment of the money market.

End-2019 forecast of the structural liquidity surplus has been kept at 2.8-3.3 trillion rubles.

THE INTEREST RATE PATH EXPECTED BY MARKET PARTICIPANTS DID NOT CHANGE SIGNIFICANTLY

Table 1

1. Expectations based on market indicators,* interest rate (instrument)	April 2019	July 2019
– MosPrime 3M (FRA)	8.81 (9.05)	8.86 (9.53)
– RUONIA (ROISfix)	7.81 (8.07)	7.94 (8.44)
– RUONIA (futures)	7.86 (7.93)	7.97 (8.24)
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.

STRUCTURAL LIQUIDITY SURPLUS FORECAST FOR END-2019 HAS BEEN KEPT AT 2.8–3.3 TRILLION RUBLES (TRILLIONS OF RUBLES)

Table 2

	January 2019	2019 (forecast)
1. Liquidity factors (supply)	**0.0**	**[0.1; 0.6]**
- changes in the balances of general government accounts with the Bank of Russia and other operations*	-0.5	[0.7; 1.1]
- change in cash in circulation	0.5	[-0.6; -0.5]
- Bank of Russia interventions in the domestic FX market and monetary gold purchases**	0.0	0.0
- regulation of banks' required reserves with the Bank of Russia	0.0	0.0
2. Change in free bank reserves (correspondent accounts) (demand)	**0.3**	**0.4**
3. Change in banks' claims on deposits with the Bank of Russia and coupon OBRs	**-0.3**	**[-0.2; 0.3]**
4. Change in outstanding amounts on Bank of Russia refinancing operations (4 = 2 + 3 - 1)	**0.0**	**0.0**
Structural liquidity deficit (+) / surplus (-) (as of the period-end)	**-2.7**	**[-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.*

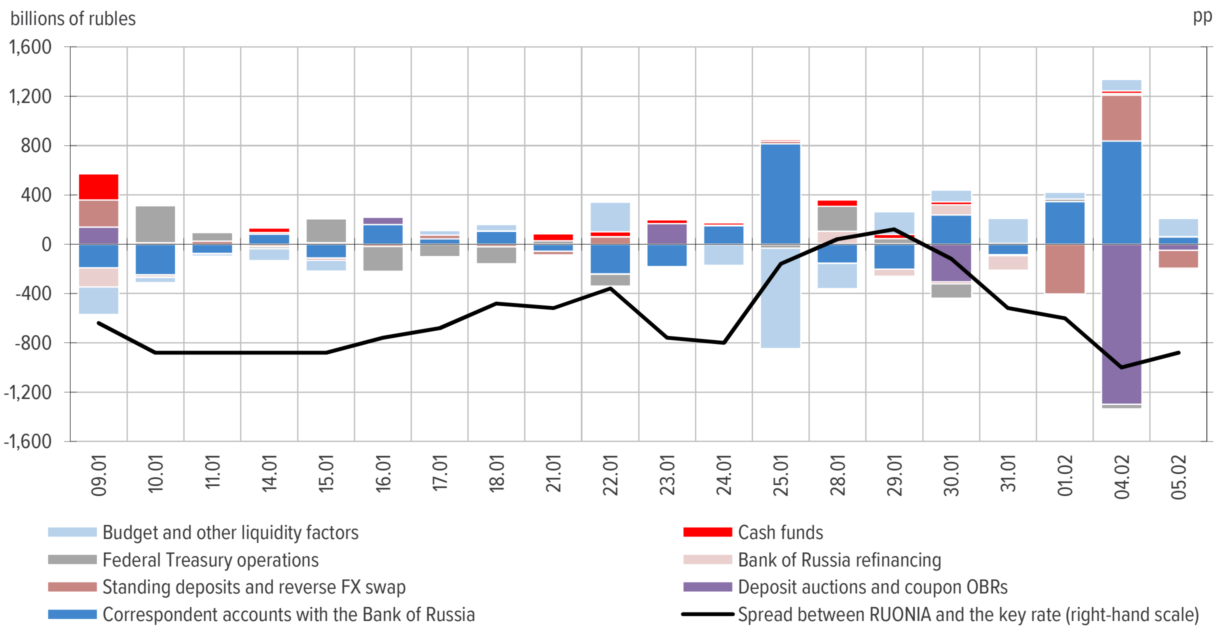
*** Forecast values of the indicator correspond to the actual volume of operations conducted.*

Source: Bank of Russia calculations.

IN JANUARY 2019, THE OUTFLOW OF FUNDS VIA THE BUDGET CHANNEL WAS PARTIALLY OFFSET BY THE RETURN OF CASH FUNDS TO BANKS AFTER THE NEW YEAR HOLIDAYS AND THE RESUMED PURCHASES OF FOREIGN CURRENCY BY THE BANK OF RUSSIA IN THE DOMESTIC MARKET UNDER THE FISCAL RULE IMPLEMENTATION

Chart 1

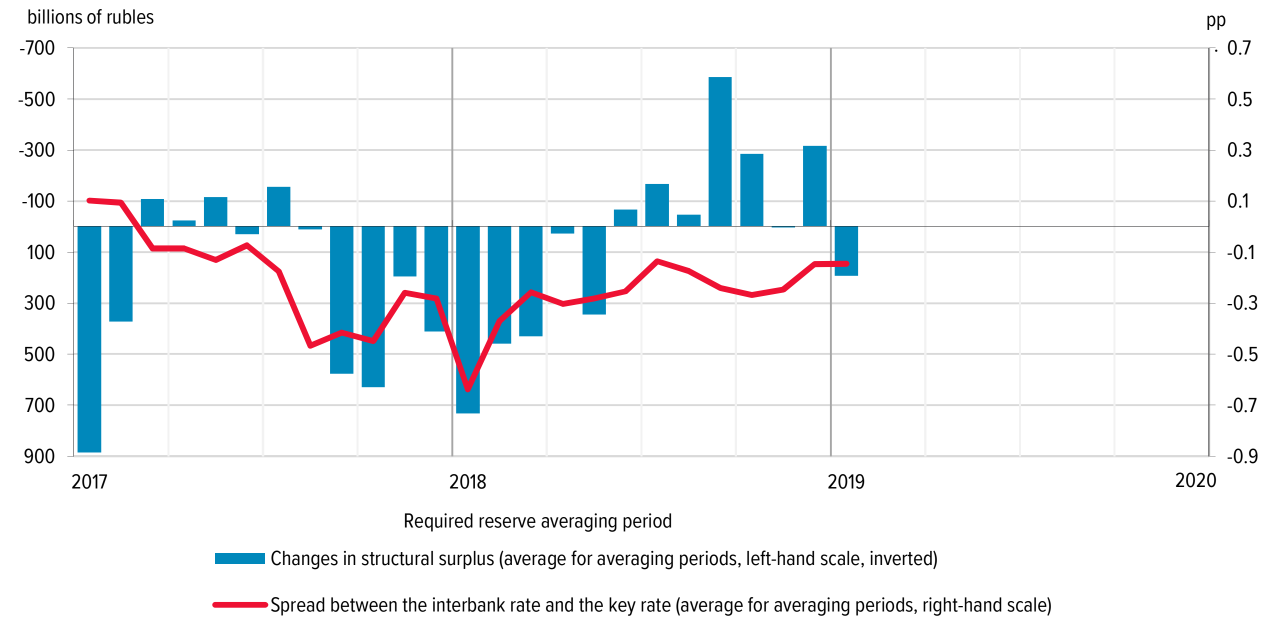
CHANGES IN THE BANK OF RUSSIA BALANCE SHEET AND MONEY MARKET RATES (OVERNIGHT)



Source: Bank of Russia calculations.

SPREAD BETWEEN INTERBANK RATES AND BANK OF RUSSIA KEY RATE WAS SLIGHTLY NEGATIVE AT -15 BP IN THE JANUARY AVERAGING PERIOD

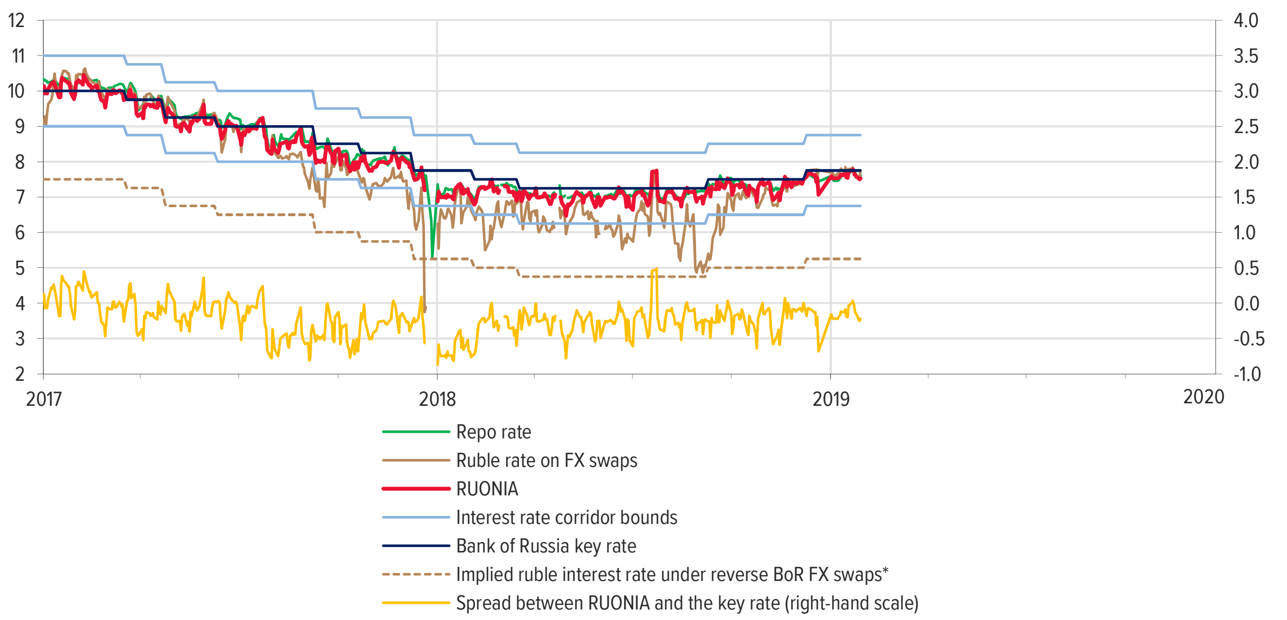
Chart 2



Source: Bank of Russia calculations.

MONEY MARKET RATES WERE CLOSE TO BANK OF RUSSIA KEY RATE (PP)

Chart 3

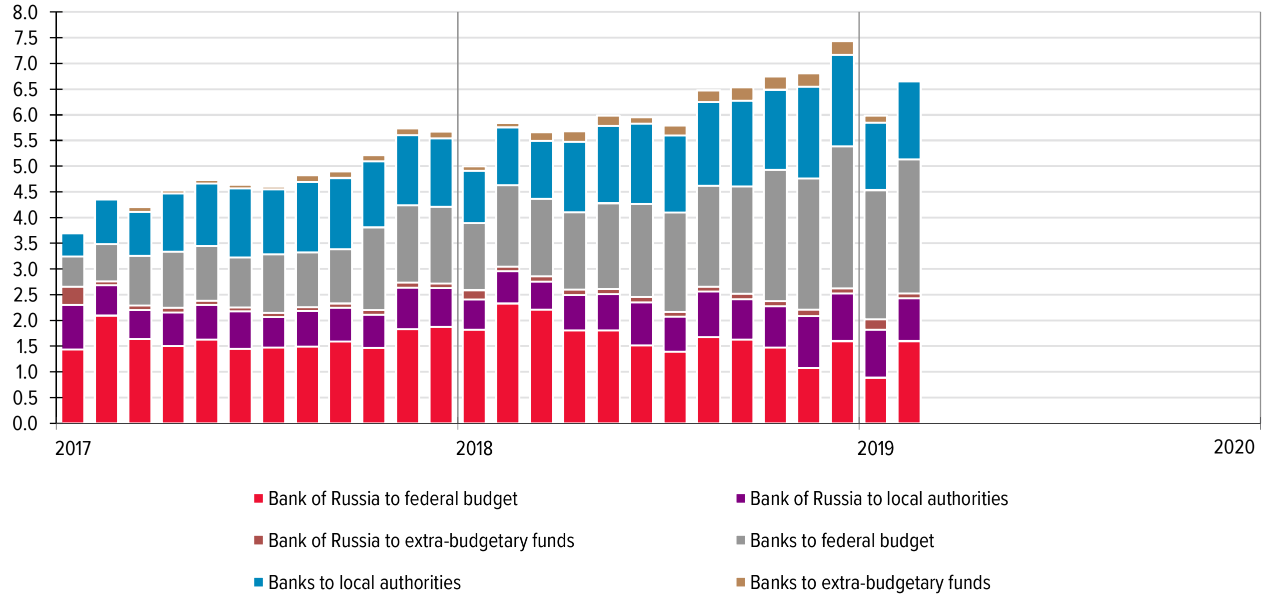


** Implied rate = ruble lending rate - FX borrowing rate + LIBOR*
(from 19.12.2016: key rate - 1 pp - (LIBOR + 1.5 pp) + LIBOR = key rate - 2.5 pp).

Source: Bank of Russia calculations.

THE FEDERAL TREASURY AND BUDGETS OF RUSSIAN CONSTITUENTS INCREASED BALANCES OF FUNDS PLACED WITH BANKS AND IN ACCOUNTS WITH THE BANK OF RUSSIA (TRILLIONS OF RUBLES)

Chart 4



Source: Bank of Russia calculations.

IN JANUARY 2019, THE BANKING SECTOR'S STRUCTURAL LIQUIDITY SURPLUS DECREASED SOMEWHAT (START OF BUSINESS, TRILLIONS OF RUBLES)

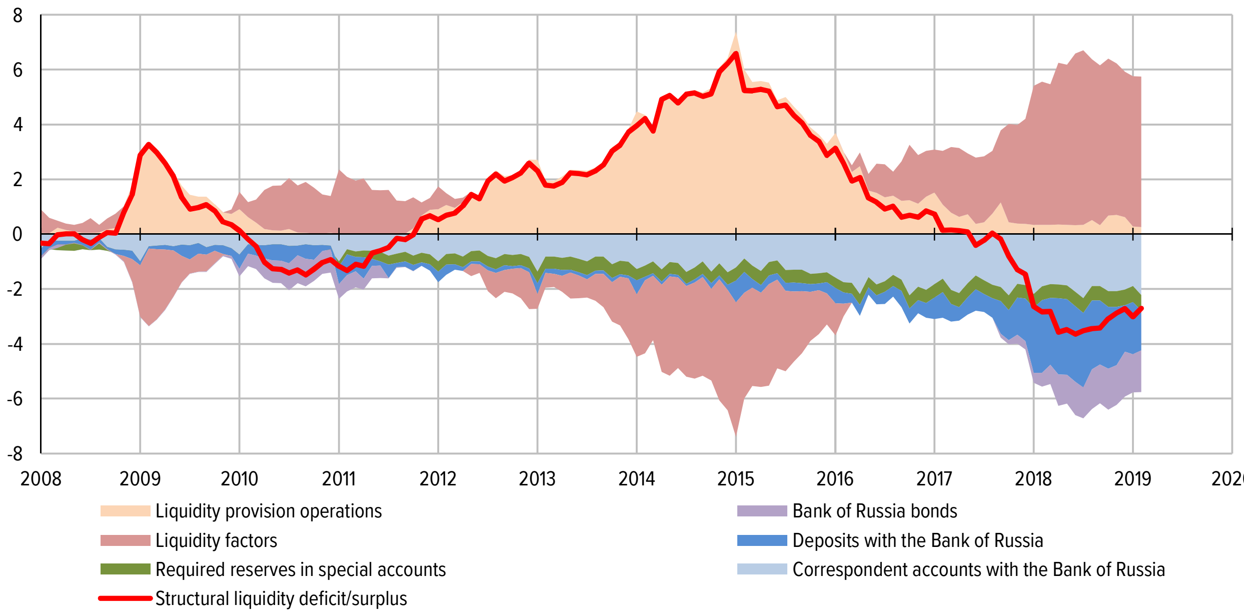
Table 3

	01.01.2017	01.01.2018	01.01.2019	01.02.2019
Structural liquidity deficit (+) / surplus (-)	**0.7**	**-2.6**	**-3.0**	**-2.7**
Bank of Russia standard monetary policy instruments				
Bank of Russia claims on credit institutions	**1.3**	**0.0**	**0.0**	**0.0**
Auction-based facilities	0.2	0.0	0.0	0.0
- repos and FX swaps	0.0	0.0	0.0	0.0
- secured loans	0.2	0.0	0.0	0.0
Fixed interest rate facilities	1.0	0.0	0.0	0.0
- repos and FX swaps	0.6	0.0	0.0	0.0
- secured loans	0.4	0.0	0.0	0.0
Credit institutions' claims on the Bank of Russia	**0.8**	**2.7**	**3.3**	**3.0**
Deposits	0.8	2.4	1.9	1.4
- auction-based	0.4	2.1	1.5	1.3
- fixed interest rate	0.4	0.2	0.4	0.1
Bank of Russia bonds	0.0	0.4	1.4	1.5
Standing reverse facilities other than Bank of Russia standard monetary policy instruments*				
Net claims of credit institutions and the Bank of Russia	0.3	0.1	0.3	0.2

** 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.

BANK OF RUSSIA BALANCE SHEET (TRILLIONS OF RUBLES) *Chart 5*



Source: Bank of Russia calculations.

FOREIGN EXCHANGE AND STOCK MARKET

Rising global demand for risk assets drives improvement in the Russian financial market in January. Investor sentiment gained a boost from softening US Fed rhetoric over forthcoming monetary policy tightening, as well as the advances in US-China trade talks and the performance of oil prices, with Brent upwards of $60 per barrel.

Foreign exchange rate. The US dollar/ruble exchange rate rose by 5.8% in January. Other EM currencies also strengthened, although their growth was somewhat lower. The JP Morgan EM currency index grew by 3.3% in the period under review. Stronger ruble dynamics can be explained by its recovery after a significant depreciation in late 2018, which was caused by a one-off factor, i.e. increased demand for foreign currency from some major market participants.

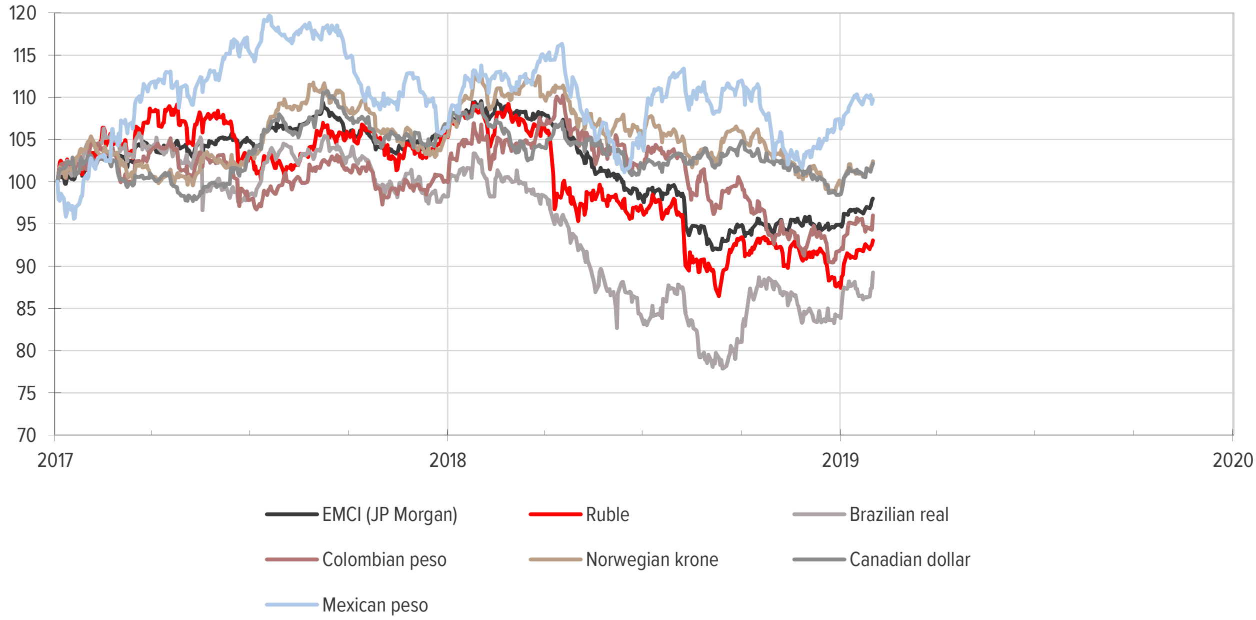
Country risk premium. CDS spread for Russia (5 years) fell by 22 bp which is comparable with the average CDS dynamics of other EMEs (-24 bp). According to Bank of Russia model estimates that take into account a number of macroeconomic factors, the observed decline in EM CDS spreads looks slightly excessive.

OFZ. Positive trends were also observed in the government bond market. Yields of long-term OFZs dropped by 50-60 bp amid increased purchases from foreign investors. According to the exchange data, non-residents built up their investments by 55 billion rubles. This is a record high from January 2018. About a half of this volume was acquired at auctions, the rest in the secondary market. The inflow of non-resident funds in the secondary market was also observed for the first time since January 2018. Apart from non-residents, systemically important banks were active buyers of OFZs (38.6 billion rubles).

Stocks. The ruble-denominated MOEX Index grew by 6.4% hitting an all-time high and the dollar-denominated MSCI Russia Index increased by 13.2% returning to the level of last April. According to the exchange data, non-residents acquired Russian stocks totalling a five-year record high of 37.8 billion rubles (earlier statistics are unavailable).

THE RUBLE EXCHANGE RATE ROSE SIGNIFICANTLY AS DID EXCHANGE RATES OF OTHER EM CURRENCIES (03.01.2017 = 100)

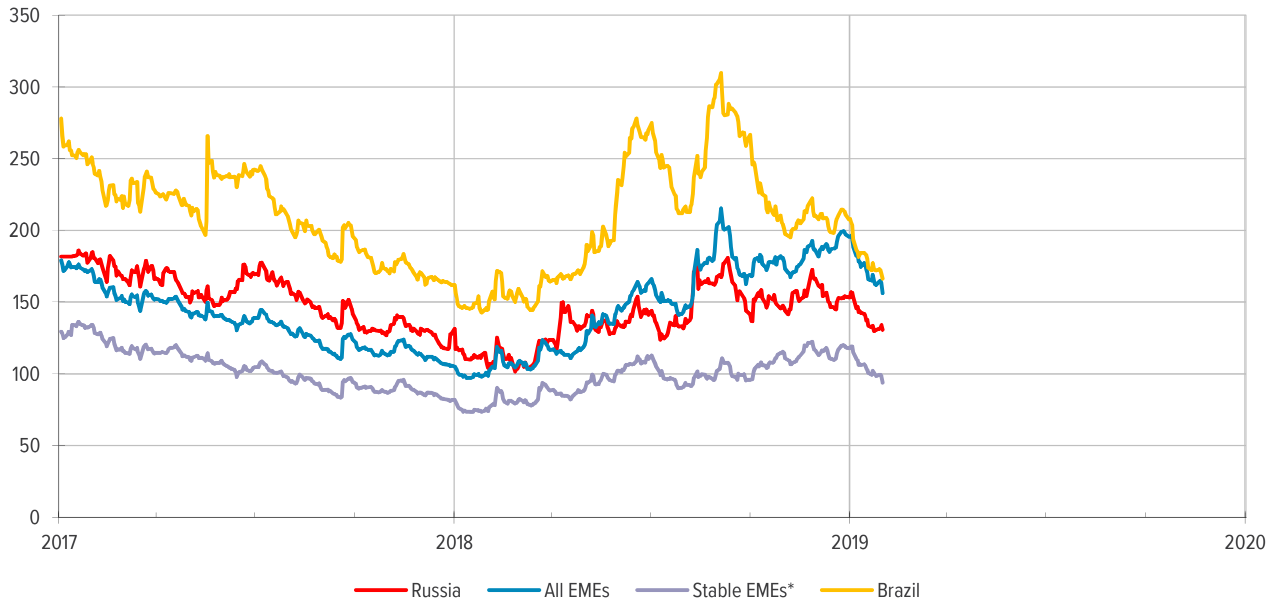
Chart 6



Source: Bank of Russia calculations.

IN JANUARY, CDS SPREADS DECREASED SHARPLY AMID GROWING DEMAND FOR RISK (BP)

Chart 7

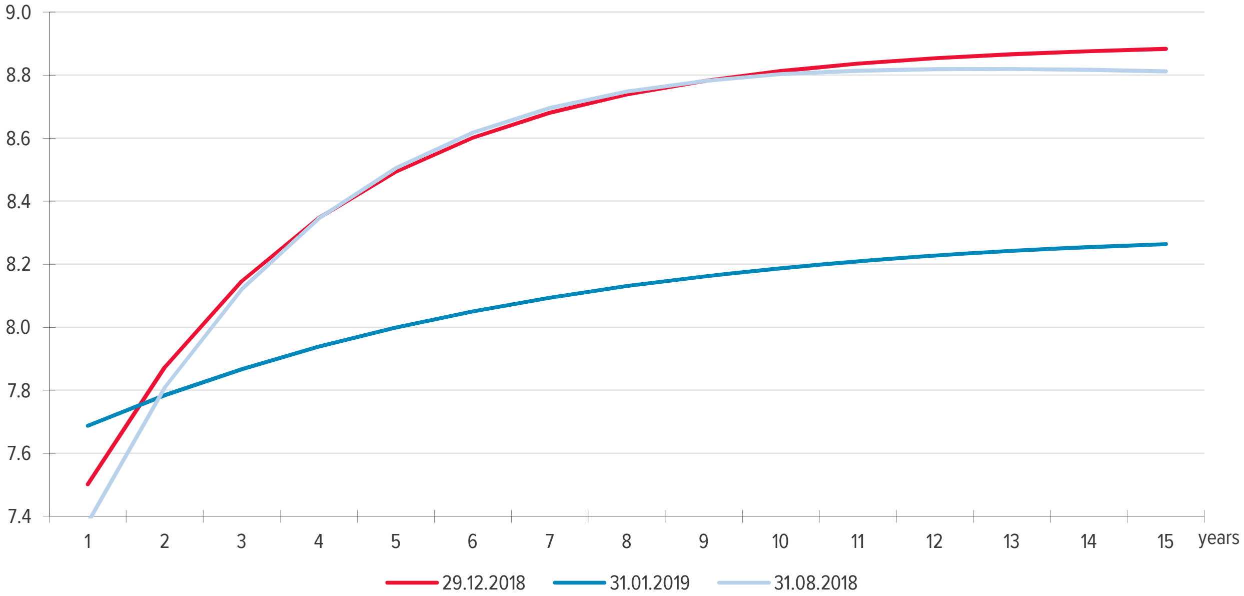


** The average CDS spread calculated based on CDS for China, Indonesia, Panama, Colombia, Chile, Peru, Mexico, Malaysia and the Philippines.*

Sources: Bloomberg, Bank of Russia calculations.

OFZ ZERO COUPON YIELD CURVE SHIFTED DOWNWARDS OWING TO FOREIGN INVESTORS' PURCHASES (% P.A.)

Chart 8



Source: PJSC Moscow Exchange.

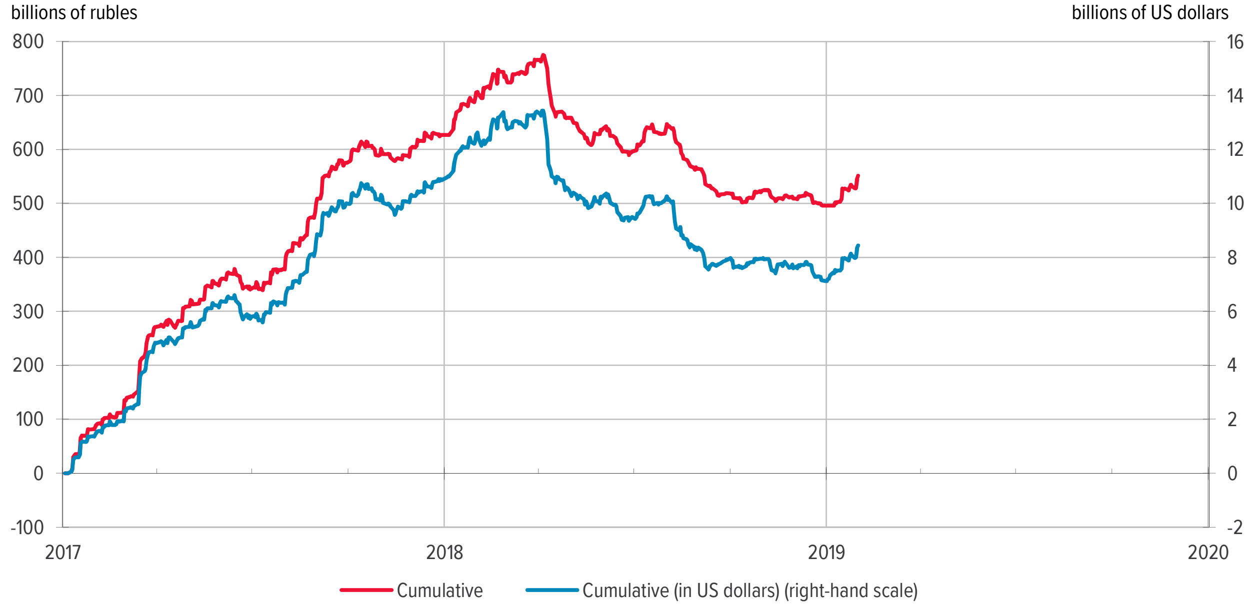
RUSSIAN STOCK INDICES GREW FOLLOWING THE GLOBAL MARKETS TREND (03.01.2017 = 100)

Chart 9

Sources: Bloomberg, Bank of Russia calculations.

JANUARY SAW THE RECORD VOLUME OF OFZ PURCHASES BY FOREIGN INVESTORS (ACCORDING TO EXCHANGE DATA)

Chart 10



Source: Bank of Russia calculations.

MOST SEGMENTS OF THE RUSSIAN MARKET SAW PRICE GROWTH

Table 4

Stock market indicators					
Segment	Indicator	As of 29.12.2018 COB*	Change**		2017 average*
			monthly	monthly average	
Equity market	MICEX index	2,521.1	6.4	3.5	2,039.8
	RTS index	1,214.5	13.6	4.9	1,101.9
Bond market	OFZ	8.02	-37	-29.5	7.9
	Corporate bonds	8.85	-29	-15.9	8.9
	Regional bonds	8.58	8	-16.3	8.5
Foreign market	Russia-43	5.11	-34.1	-30.3	4.9
	UST-10	2.63	-9	-12	2.3
Risk appetite indicators	RVI	21.9	-5.2	-3.4	21.3
	EMBI+ Russia	210	-32	-22.3	145.1
	EMBI+ EM	386.9	-53.7	-29.1	326.6
	CDS	130.7	-23.1	-15.1	156

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

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

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

CREDIT AND DEPOSIT MARKET

In December 2018, the deposit market saw interest rates growth underpinned by bank competition for depositors. In January 2019, a number of major banks raised their rates on deposits. In the majority of cases, the increase covered standard deposit products rather than seasonal deposits, which are typical of December. This allows one to expect further growth in average market rates in early 2019. The last few months of 2018 saw increased interest of banks in household dollar deposits. In 2018 Q4, interest rates on these deposits rose somewhat faster than on ruble deposits of comparable maturity.

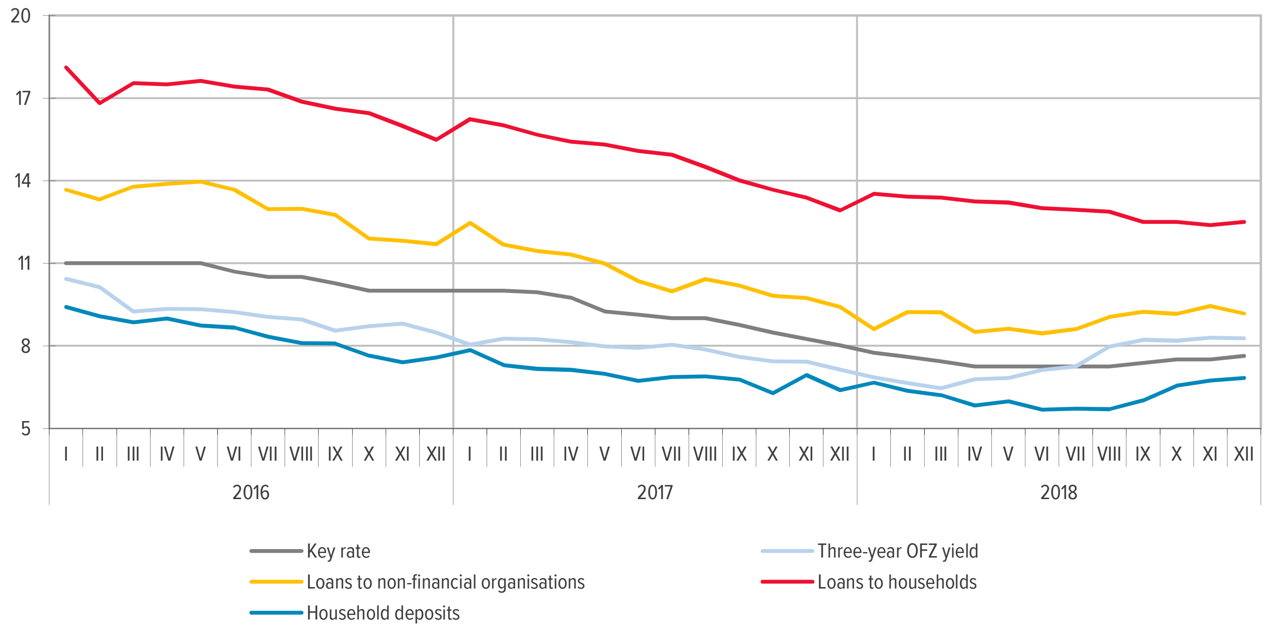
In late 2018 - early 2019, the credit market also saw interest rate growth. This trend was unsustainable, however, and rates were observed to decline in certain months. As a result, the average market rate in most segments of the credit market grew noticeably less than the deposit rate (Chart 11).

Deposit market. Higher interest rates on deposits raised their attractiveness for households. Owing to an outpacing increase of interest rates on foreign currency deposits the outflow of funds from FX deposits observed over the past few years halted for a while. In November 2018, balances of household foreign currency deposits increased gradually. However, growth over the past few months was insufficient to replenish the earlier observed outflow of household funds from FX deposits. Annual growth rates of FX deposits remained negative, while the dollarisation of household deposits fluctuated near the current level (Chart 12).

Credit market. December 2018 saw the slowing of growth in both corporate and retail lending (Chart 13). However, this slowing was largely technical and related to the writing-off of overdue debts by a number of banks, which noticeably improved the credit portfolio quality (Chart 13), and large-scale operations to securitise mortgage loans. Preliminary data for January 2019 show the recovery in both the retail and corporate segments of the credit market. Banks' claims on the economy rose by

BANK RATES LARGELY INCREASED IN LATE 2018 AND THIS TREND WAS MORE PRONOUNCED IN THE DEPOSIT MARKET *Chart 11*

RATES ON BANKS' LONG-TERM RUBLE TRANSACTIONS (% P.A.)

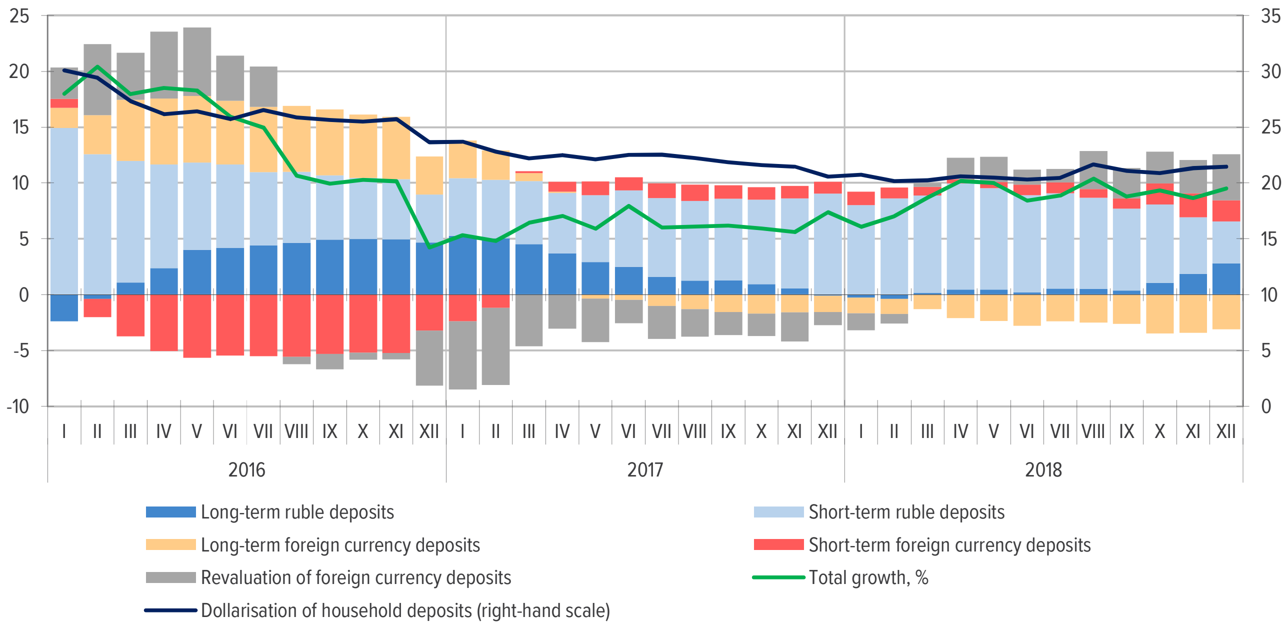


Source: Bank of Russia calculations.

THE OUTFLOW OF HOUSEHOLD FUNDS FROM FX DEPOSITS HALTED IN LATE 2018 OWING TO AN INCREASE IN DEPOSIT INTEREST RATES

Chart 12

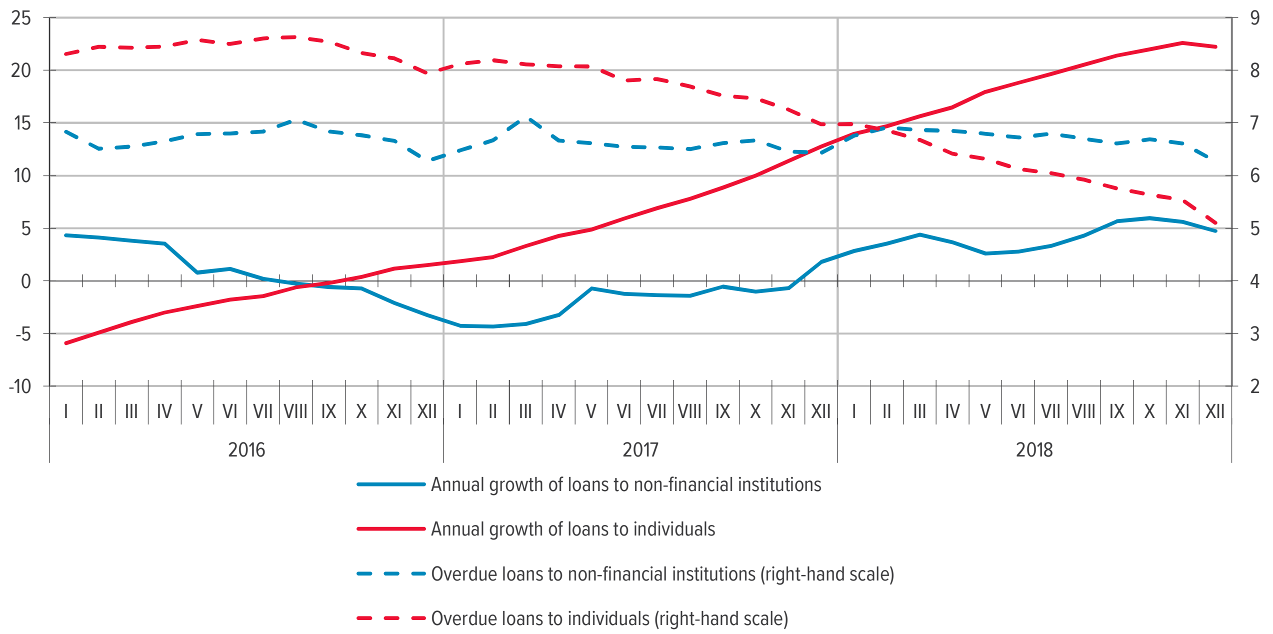
CONTRIBUTION OF INDIVIDUAL ELEMENTS TO ANNUAL GROWTH OF HOUSEHOLD DEPOSITS (PP)



Source: Bank of Russia calculations.

DECEMBER 2018 SAW SLOWING GROWTH IN LENDING COUPLED WITH IMPROVED QUALITY OF THE LOAN PORTFOLIO, WHICH WERE FACILITATED BY THE PARTIAL WRITING-OFF OF OVERDUE DEBT (%)

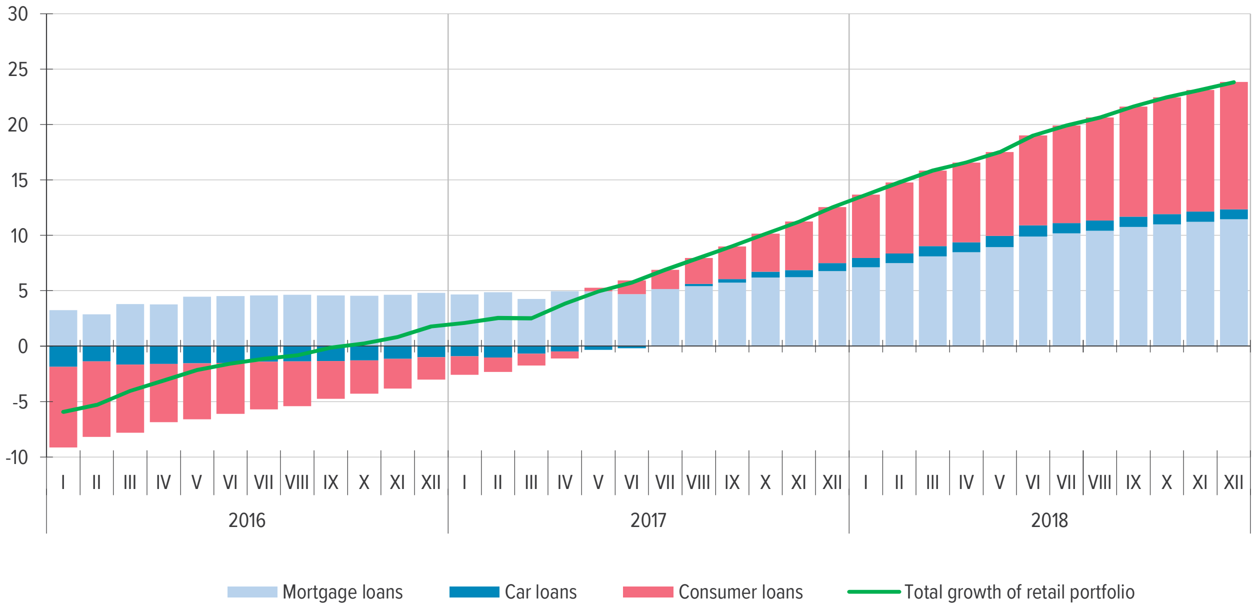
Chart 13



Source: Bank of Russia calculations.

IN LATE 2018, MORTGAGE AND CONSUMER LENDING MADE A COMPARABLE CONTRIBUTION TO RETAIL LENDING DYNAMICS *Chart 14*

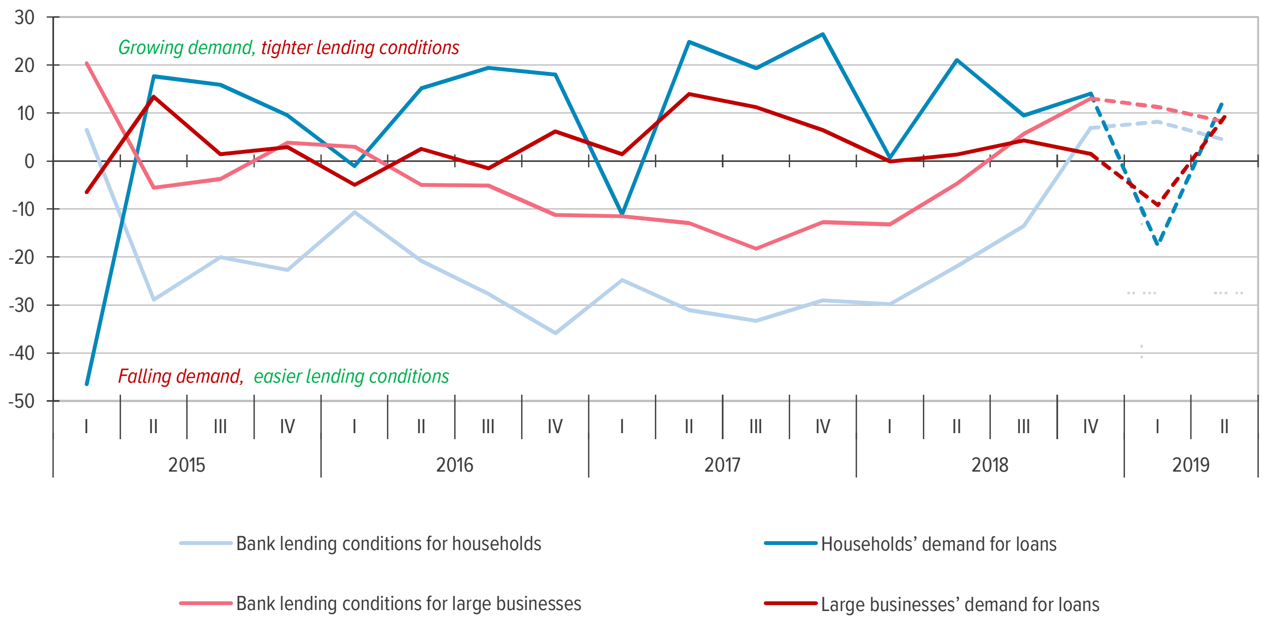
CONTRIBUTION OF INDIVIDUAL COMPONENTS TO ANNUAL GROWTH OF RETAIL LOAN PORTFOLIO (PP)



Source: Bank of Russia calculations.

THE MODERATE TIGHTENING OF LENDING CONDITIONS IN LATE 2018 AND EARLY 2019 WAS LARGELY DUE TO HIGHER CREDIT RATES *Chart 15*

LENDING CONDITIONS AND DEMAND FOR LOANS INDICES (PP)



Source: Bank of Russia.

over 0.7 trillion rubles[1], despite the expected seasonal decline in demand for loans (Chart 15).

According to a quarterly survey, major Russian banks attribute the tighter lending conditions to higher credit rates. In the second half of 2018, non-price lending conditions, in particular the requirements for the borrower's financial position, were neither tight nor easy.

In the past few months of 2018, corporate lending, broken down by industry, saw the rising share of loans to the mining and quarrying industry and agriculture, as well as a certain recovery in the trade lending segment. In the retail segment of the market, the shares of mortgage and consumer lending in credit portfolio growth remained comparable (Chart 14).

[1] *Adjusted for foreign currency revaluation.*

Cut-off dates:
- 'Banking sector liquidity and money market' section – 5 February 2019 (reserve requirements are an important part of the Bank of Russia's instruments to manage 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 reserve averaging periods. In January-February 2019, this period is from 9 January 2019 to 5 February 2019);
- 'Foreign exchange and stock market' section – 31 January 2019;
- 'Credit and deposit market' section – 1 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.

This commentary is prepared by the Monetary Policy Department.

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