



Bank of Russia

No. 2

**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 October 2018 – September 2019.

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 the presentation of data 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 account 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 dollars, Australian dollars, Swiss francs, yen, yuan 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 in 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 the 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 in the 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 the foreign currency assets of the Bank of Russia includes the identification of risks, risk assessment, the setting of risk limits, and monitoring of compliance with the limits. Under the 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 for net foreign exchange assets, with target weights or amounts of the corresponding currencies and the limits for 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 the 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 the fulfilment of which these funds may 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 government funds, 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 balances in the foreign currency accounts of the Federal Treasury earmarked for crediting to the National Wealth Fund based on the money market rates in the respective currencies. 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 do not expose it to interest rate or 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's 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.

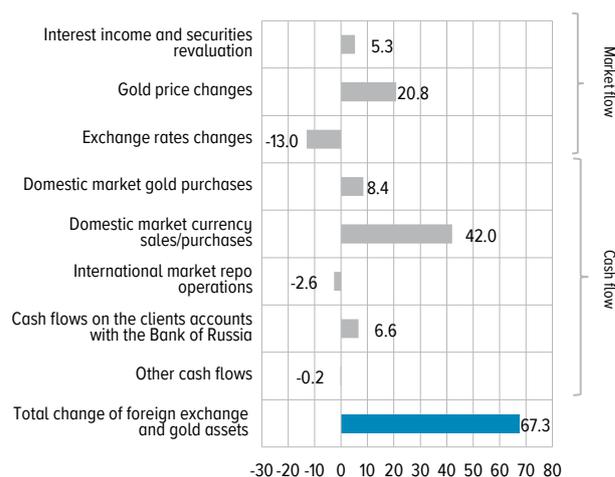
2. FOREIGN EXCHANGE AND GOLD ASSET MANAGEMENT IN OCTOBER 2018 – SEPTEMBER 2019

In the period under review, Bank of Russia foreign exchange and gold assets increased by \$ 67.3 billion, to reach \$ 527.1 billion (Table 1). The main drivers of the increase were foreign currency purchases (Chart 1) carried out as part of the Federal Treasury's foreign currency acquisitions from the Bank of Russia under the implementation of the fiscal rule. Gold purchases from Russian credit organisations and changes in the price of gold were other factors in the growth in the value of assets. Inflow of client funds to accounts with the Bank of Russia also contributed to the increase in assets. The growth in assets was in part offset by changes in foreign exchange rates against the US dollar and the decrease in the amount of the Bank of Russia's unsettled repo operations with foreign counterparties as of the reporting date. These transactions 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 in deposit, reverse repo or nostro accounts in the correspondent bank.

In October 2018 – September 2019, the government securities portfolio and the amount of deposits and nostro account balances with foreign counterparties increased (Table 1).

As of 30 September 2019, the category "Others" in Chart 2 includes assets in yen (3.6%) and the Canadian (2.3%) and Australian (0.8%) dollars. The balance of accounts in Swiss francs was negligible.

CHANGES IN FOREIGN EXCHANGE AND GOLD ASSETS IN OCTOBER 2018 – SEPTEMBER 2019 (BILLION US DOLLARS) *Chart 1*



FOREIGN EXCHANGE AND GOLD ASSETS BY ASSET CLASS

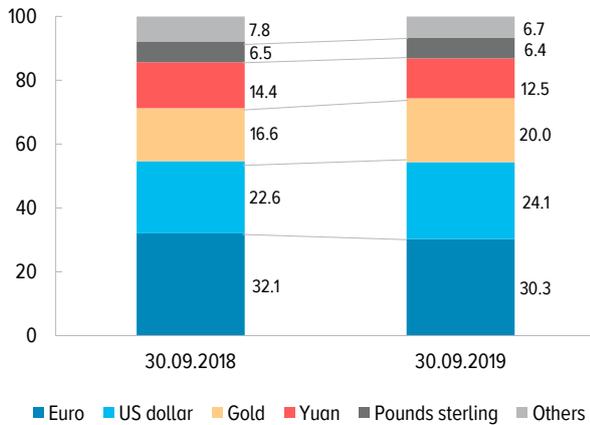
Table 1

Assets	As of 30 September 2018		As of 30 September 2019		Change in October 2018 – September 2019, billion US dollars
	billion US dollars	share of assets, %	billion US dollars	share of assets, %	
Government securities of foreign issuers*	196.7	42.8	209.3	39.7	12.6
Deposits and account balances with foreign counterparties	129.5	28.2	142.7	27.1	13.2
Gold	76.3	16.6	105.4	20.0	29.1
Non-government securities of foreign issuers	32.1	7.0	41.9	8.0	9.9
Securities of international organisations	14.4	3.1	17.6	3.3	3.2
Reverse repo operations with foreign counterparties	6.1	1.3	5.0	1.0	-1.1
Net position with the IMF	1.9	0.4	2.8	0.5	0.9
Claims in foreign currency on Russian counterparties and issuers**	2.8	0.6	2.2	0.4	-0.5
Claims on foreign counterparties on foreign currency supply	0.0	0.0	0.1	0.0	0.1
Total***	459.7	100.0	527.1	100.0	67.3

* Securities issued by foreign governments 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*

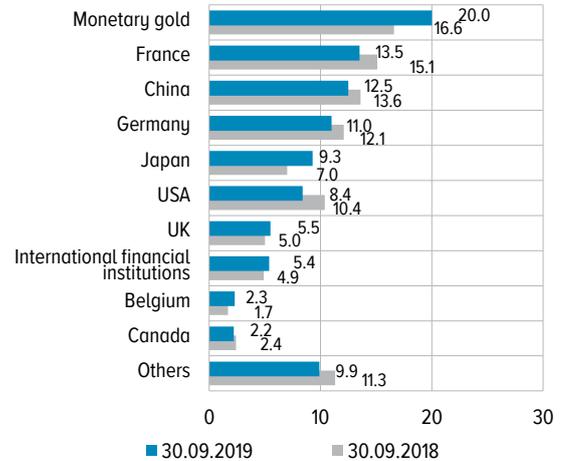
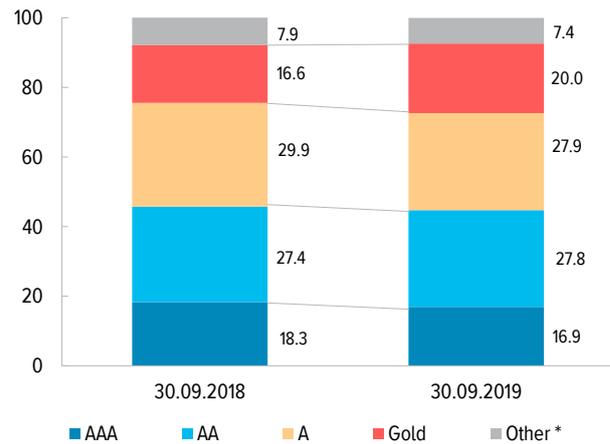
* The distribution takes into account unsettled conversion transactions as of 30 September 2018 and 30 September 2019.

The SDR-denominated net claims of the Russian Federation to the IMF were accounted for in the breakdown as assets in the foreign currencies included in the SDR basket, in the proportions determined by the IMF for calculating the value of SDRs.

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

Chart 4 shows the distribution of assets by credit rating. The Chart is based on Fitch Ratings, S&P Global Ratings and Moody's Investors Service data, with the lowest credit rating grades used.

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

GEOGRAPHIC STRUCTURE 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 OCTOBER 2018 – SEPTEMBER 2019 (% P. A.)

Table 2

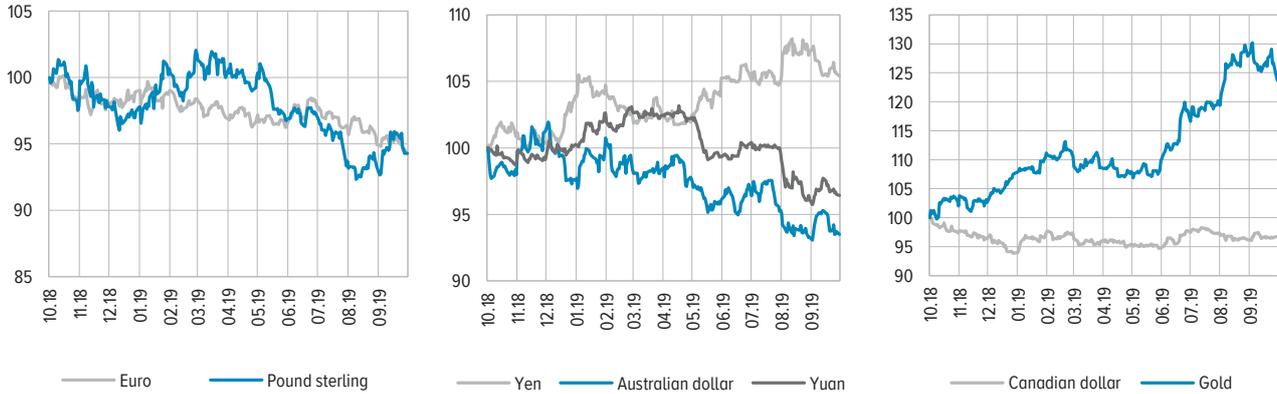
Indicator	US dollar	Euro	Pound sterling	Canadian dollar	Australian dollar	Yuan	Yen
Return on actual single-currency portfolios of foreign exchange assets	1.92	-0.05	1.05	2.30	2.59	3.96	0.01
Return on benchmark single-currency portfolios of foreign exchange assets	1.80	-0.15	0.90	2.22	2.45	3.82	-0.16

* The term is defined in the glossary.

ANNEX

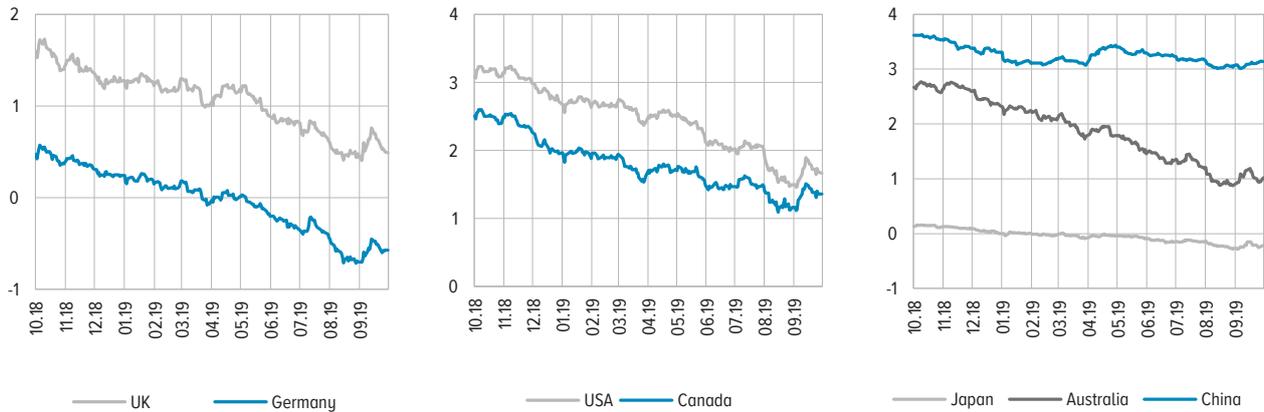
CHANGES IN EXCHANGE RATES AND GOLD TO THE US DOLLAR (AS % OF START OF PERIOD)

Chart 1



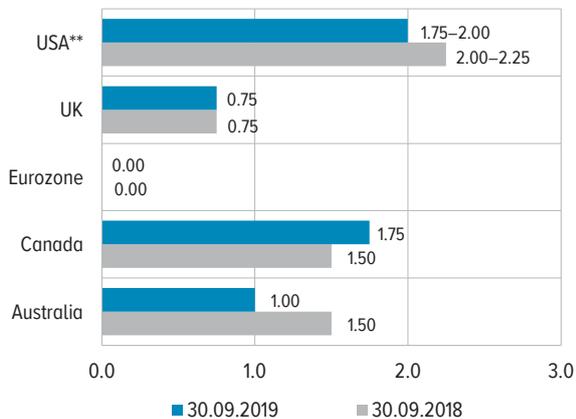
YIELDS TO MATURITY ON 10-YEAR GOVERNMENT BONDS (% P.A.)

Chart 2



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

Chart 3



* The term is defined in the glossary.

** The Fed funds target rate was 2.00-2.25% as of 30 September 2018 and 1.75-2.00% as of 30 September 2019.

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 banks key rate	<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> <i>Examples of key rates used by the leading central banks include:</i> <ul style="list-style-type: none"> • <i>US Federal Reserve System (Fed) – A target for the interest rate at which depository institutions lend reserve balances to other depository institutions overnight;</i> • <i>European Central Bank (ECB) – The minimum rate at ECB repo auctions;</i> • <i>Bank of England – The interest rate on commercial bank reserves deposited with the Bank of England;</i> • <i>Bank of Canada – A target for the interbank loan rate;</i> • <i>Reserve Bank of Australia – A target for the interbank loan rate;</i> • <i>Bank of Japan (BoJ) – BoJ targets an annual amount of asset purchases (since 2013), the level of 10-year JGB yields (since 2016) and applies a negative interest rate to the reserves of financial institutions held in BoJ accounts (since 2016)</i>
Credit rating	<i>A rating agency's assessment of the creditworthiness of a borrower and its ability to fulfil 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 deposits with the Bank of Russia (in US dollars, euros and pounds sterling)</i>
Repo (reverse repo) transactions	<i>Securities sale (purchase) transactions with the obligation of their repurchase (resale) on a 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 a chain index based on the daily return. The daily return on a single-currency portfolio is calculated as the ratio of the aggregate (realised and unrealised) returns 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>