



Bank of Russia

The Central Bank of the Russian Federation



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FOREIGN EXCHANGE  
ASSET MANAGEMENT  
REPORT**

Moscow



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## FOREWORD

This issue of the Bank of Russia Foreign Exchange Asset Management Report presents the results of foreign exchange asset management in October 2014 – September 2015.

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 asset management are published at least six months after the end of the reporting period.

Information on Bank of Russia foreign exchange assets is also published in the Bank of Russia

Annual Report (data on foreign exchange reserve assets and gold assets) and on the website of the Bank of Russia (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](mailto:reservesmanagement@mail.cbr.ru).

## PRINCIPLES OF FOREIGN EXCHANGE 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 Eurobonds and other claims on counterparties. These assets are denominated in US dollars, euros, pounds sterling, Canadian and Australian dollars, yen, *Special Drawing Rights (SDR)*, and Swiss francs (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.

For the purpose of management foreign exchange assets 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.

Foreign exchange asset management takes into account the Bank of Russia's liabilities in foreign currencies (balances on foreign currency accounts of clients, mainly *government funds*). Foreign currency holdings expose the Bank of Russia to financial risks, such as credit risk, foreign exchange risk, interest rate risk and liquidity risk.

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 Standard and Poor's 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 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 Banks of Russia assets portfolios was measured by *duration*. The interest rate risk exposure was 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 Bank of Russia pays interest on foreign currency accounts balances equal to the rate of return on indices composed of foreign countries' bonds. The Bank of Russia makes interest payments 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 Committee in charge of investment strategy 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 authorized divisions of the Bank of Russia. External managers are not involved in foreign exchange asset management.

## MACROECONOMIC TRENDS IN OCTOBER 2014 – SEPTEMBER 2015

The foreign currency exchange rates and government securities yields in major developed economies throughout the period under review were primarily driven by the ongoing sovereign debt problems in certain euro area member states, the China slowdown and *quantitative easing* (QE) programmes in the USA, euro area and Japan.

### America

In November 2014, the Federal Open Market Committee (FOMC) decided to end the QE programme. At the December meeting, the Fed dropped the pledge to keep interest rates near zero for a “considerable time” and instead said that it “can be patient” about the timing of monetary policy tightening.

In March 2015, the Fed modified its language by abandoning the “patient” wording, indicating the lift-off was on the cards. The FOMC also stressed the preconditions needed for a rate hike – further improvement in the labour market and reasonable confidence that inflation will return to the 2% target over the medium term.

In June–September 2015, the Fed revised its forecasts on the US economy downward (given negative spillovers from global financial market turbulence and weakening EM economies). The decisions undertaken by the FOMC as well as poor data from the US labour market in June–September 2015 undermined expectations for the first rate hike. This, in turn, resulted in lower US Treasuries yields and led to a pause in the US dollar appreciation against other global currencies.

In January 2015, the Bank of Canada unexpectedly cut its key rate by 0.25 pp to 0.75%. The BoC based its decision on the slump in oil prices that was going to put economic growth and inflation under pressure. In July 2015, the BoC lowered the key rate further by 0.25 pp to 0.50% amid consistently falling investments in energy sector and inflation hovering near 2%. Canada entered recession after GDP contracted by 0.7 and 0.3% in 2015 1Q and 2Q respectively.

### Europe

In December 2014, the euro area saw the first signs of deflation, with prices down by 0.2% year on year.

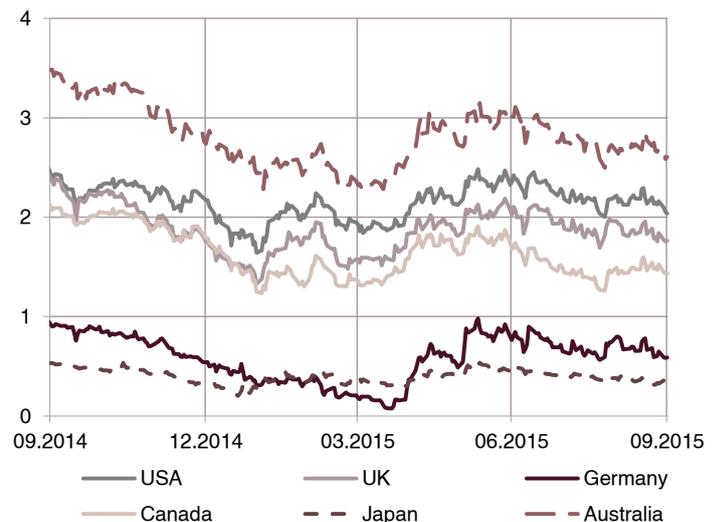
At the meeting in January 2015, the ECB decided to start the purchase of euro area government bonds in March 2015 and finish it in September 2016. The amount of purchases should total 1.1 tn euros.

In June 2015, Greece missed the IMF payment amounting to 1.6 bn euros. The government announced a national referendum for 5 July on the issue of accepting international creditors’ demands. Despite the fact that the population of Greece rejected the international creditors’ conditions, the government introduced its own reform agenda containing only minor differences from these conditions. Credit risk growth in the euro area contributed much to the weakening of the euro against the US dollar in the first half of the year.

**Chart 1. Changes in exchange rates to the US dollar, as % of start of period**



**Chart 2. Yields to maturity on 10-year government bonds, % p.a.**



The Swiss National Bank abolished the exchange rate ceiling of the Swiss franc, which caused a 15% surge of the franc against the euro. In December 2014 and January 2015, the bank cut the deposit rate from 0 to  $-0.25\%$  and  $-0.75\%$  respectively.

In February and March 2015, the Riksbank lowered the repo rate from 0 to  $-0.1\%$  and  $-0.25\%$  respectively and announced the purchase of government bonds totalling 30 bn Swedish kronas. In July 2015, the rate dropped to  $-0.35\%$ .

### Australia and Asia

In February 2015, the Reserve Bank of Australia (RBA) cut its key rate by 0.25 pp to 2.25% for the first time since 2013. The major factors affecting the decision were the weak growth of internal demand, overvalued AUD and a decline in inflation in the last quarter of 2014.

In the second quarter of 2015, the Reserve Bank of Australia cut its key rate again by another 0.25 pp to 2%. The motivation for the decision was mainly the same as at the February cut, but this time the governor of the RBA mentioned that he expected some period of rate stabilization.

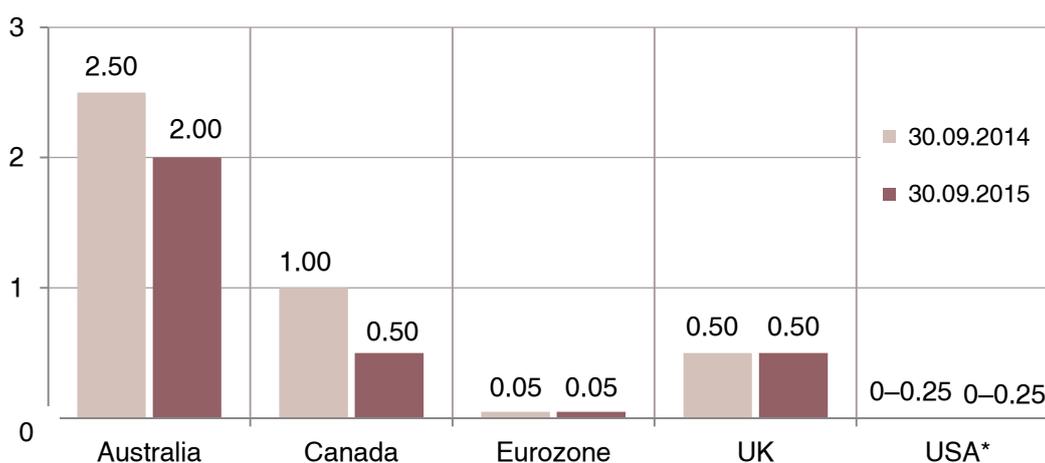
In the fourth quarter of 2014, due to weak economy performance the Bank of Japan (BoJ) announced the increase of Qualitative and Quantitative Easing programme through the purchases of government bonds. The amount of purchases was increased from JPY 60–70 tn to JPY 80 tn

annually and the average maturity of the BoJ's portfolio was extended from 7 to 10 years. Japan's prime minister postponed the second sales tax hike from November 2015 to 2017 and dissolved the lower house of Parliament. In the middle of December 2014, the ruling party won the snap elections that were considered as a confidence vote for the policy of the government.

The lack of clear plans for fiscal consolidation and poor macroeconomic performance forced Moody's rating agency to cut the sovereign rating of Japan from Aa3 to A1 in November 2014, while Fitch rating agency placed Japan's A+ rating on negative watch in December 2014.

During the period from October 2014 to September 2015, the People's Bank of China (PBoC) cut its key rates five times. As a result of these cuts, one-year benchmark lending rate was lowered by 1.4 pp to 4.6% and one-year deposit rate – by 1.25 pp to 1.75%. Additionally, deposit reserve ratio for major banks was cut three times over the same period from 20 to 18%. These actions can be explained by the attempts of economic authorities to revive moderating growth by monetary measures. In August 2015, the PBoC announced a new and more market-oriented rule for CNY mid-rate setting. Since then, the mid-rate was determined by the previous trading day closing rate. The new rule was accompanied by one-off devaluation of Chinese currency by 3%.

Chart 3. Central banks key rates, % p.a.



\* The Fed funds target rate is 0–0.25%.

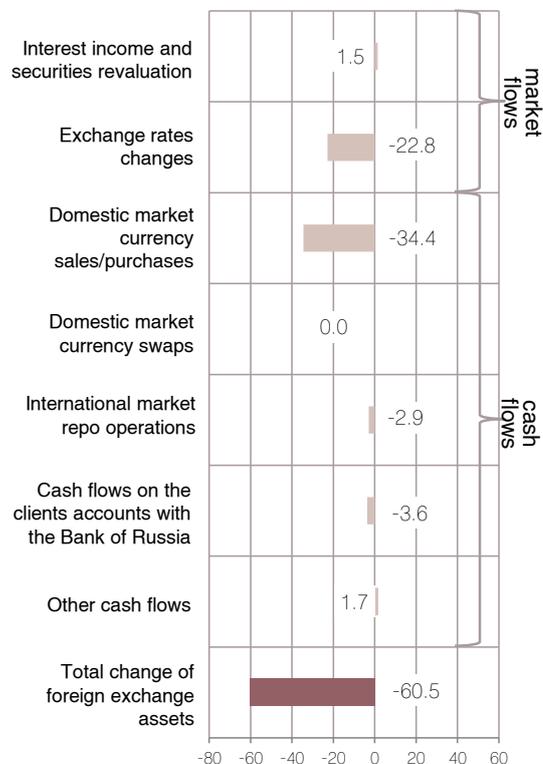
## FOREIGN EXCHANGE ASSET MANAGEMENT IN OCTOBER 2014 – SEPTEMBER 2015

In the period under review, Bank of Russia foreign exchange assets decreased by \$60.5 billion to reach \$345.5 billion (Table 1). The major reason behind this reduction was currency interventions on the domestic foreign exchange market (Chart 4). The decrease of foreign exchange assets was due to foreign currency exchange rate movements against the US dollar (Chart 1).

In October 2014 – September 2015, the government securities portfolios decreased as well as the amount of deposits and nostro account balances with the Bank of Russia (Table 1).

From October 2014, the Bank of Russia began to enter into repo transactions with Russian credit institutions in order to provide foreign currency liquidity to market participants. In 2015, the Bank of Russia also started providing loans to Russian credit institutions in foreign currency, secured by a pledge of claims under foreign currency loans.

**Chart 4. Changes in foreign exchange assets in October 2014 – September 2015, billions of US dollars**



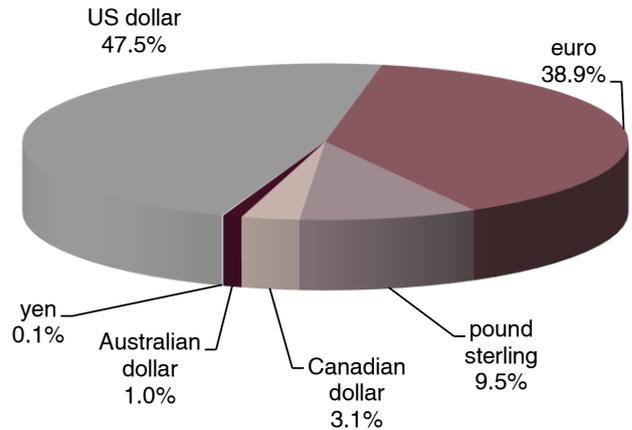
**Table 1. Foreign exchange assets by asset class**

Foreign exchange assets	As of 30 September 2014		As of 30 September 2015		Change in October 2014 – September 2015, billions of US dollars
	billions of US dollars	Share of foreign exchange assets	billions of US dollars	Share of foreign exchange assets	
Government securities	341.0	84.0%	258.4	74.8%	-82.6
Deposits and account balances	54.1	13.3%	44.0	12.7%	-10.1
Non-government securities	5.1	1.3%	10.9	3.1%	5.8
Net position with the IMF	4.0	1.0%	2.7	0.8%	-1.3
Reverse repo operations	1.2	0.3%	2.8	0.8%	1.6
Claims on counterparties on foreign currency supply	0.6	0.1%	0.0	0.0%	-0.6
Claims on Russian credit institutions under foreign currency repo operations and loans	0.0	0.0%	26.8	7.8%	26.8
<b>Total*</b>	<b>406.0</b>	<b>100.0%</b>	<b>345.5</b>	<b>100.0%</b>	<b>-60.5</b>

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

Chart 5 shows the actual currency structure of foreign exchange assets as of 30 September 2015. Assets denominated in US dollars and euros retained the dominant position in the structure.

**Chart 5. Foreign exchange assets by currency as of 30 September 2015**



**Chart 6. Geographical structure of foreign exchange assets as of 30 September 2015**

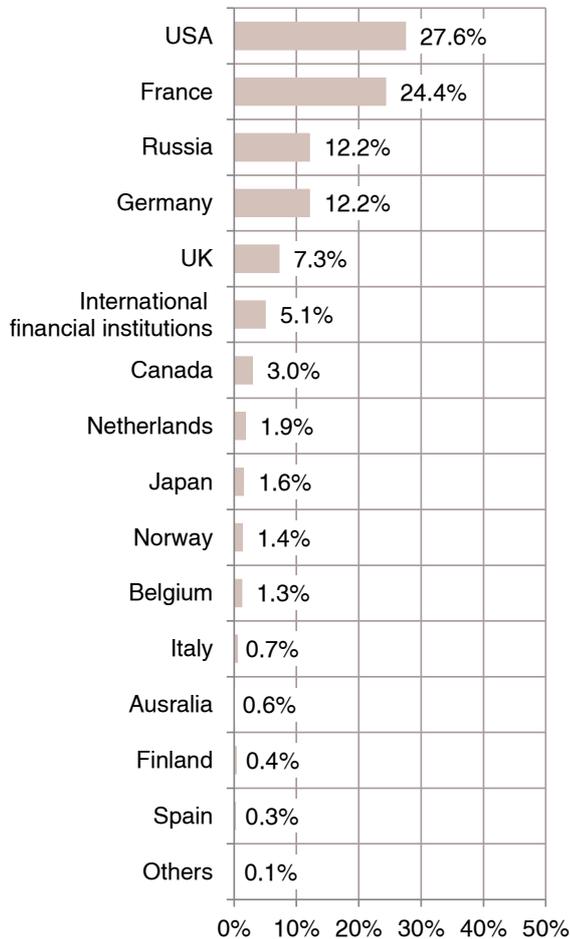
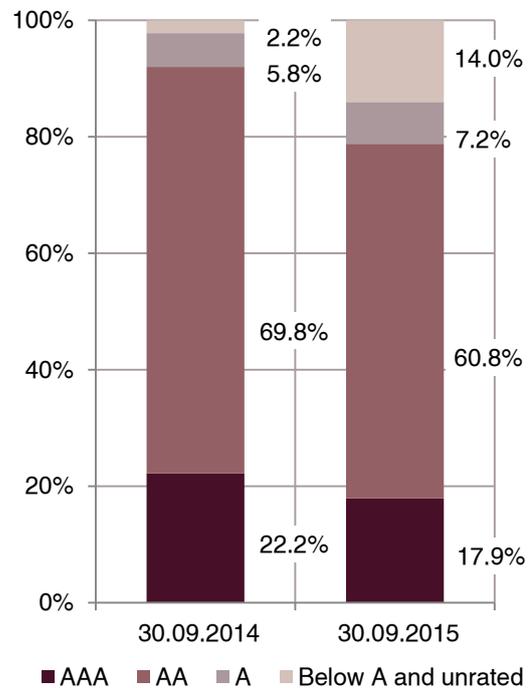


Chart 6 shows the geographical structure of foreign exchange assets by location (place of residence) of legal entities that are counterparties and issuers of the securities included in foreign exchange assets. Russia's location in the geographical structure at the third position was a result of Bank of Russia transactions on liquidity provision to Russian credit institutions in foreign currency (repo transactions and loans in foreign currency).

Chart 7 shows the distribution of foreign exchange assets by credit rating as of 30 September 2014 and 30 September 2015. The Chart is based on Fitch Ratings, Standard and Poor's and Moody's Investors Service data, with the lowest credit rating grades used.

**Chart 7. Foreign exchange assets by credit rating**



As of 30 September 2014, 'Below A and un-rated' group comprises Russian Eurobonds and Russia's position with the IMF.

Increase in the share of assets with 'Below A and unrated' rating as of 30 September 2015 was

due to the provision by the Bank of Russia to Russian credit institutions of foreign currency.

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

**Table 2. Return on Bank of Russia foreign exchange assets in October 2014 – September 2015, % p.a.**

<b>Indicator</b>	<b>US dollar</b>	<b>euro</b>	<b>pound sterling</b>	<b>Canadian dollar</b>	<b>Australian dollar</b>
Return on actual single-currency portfolios of foreign exchange assets	0.60	0.07	0.91	1.30	2.83
Return on benchmark single-currency portfolios of foreign exchange assets	0.54	0.05	0.91	1.28	2.79

## GLOSSARY

<b>Benchmark portfolio</b>	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.
<b>Central bank key rate</b>	<p>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. Examples of key rates used by the leading central banks include:</p> <ul style="list-style-type: none"><li>• US Federal Reserve System (Fed) – A target for an interest rate at which depository institutions lend reserve balances to other depository institutions overnight;</li><li>• European Central Bank (ECB) – A minimum rate at ECB repo auctions;</li><li>• Bank of England – An interest rate on commercial bank reserves deposited with the Bank of England;</li><li>• Bank of Canada – A target for an interbank loan rate;</li><li>• Reserve Bank of Australia – A target for an interbank loan rate;</li><li>• Bank of Japan – Until April 2013, this was an overnight interbank loan rate. Starting from April 2013, the Bank of Japan has been targeting the monetary base instead of the interest rate.</li></ul>
<b>Credit rating</b>	A rating agency's assessment of the credit worthiness of a borrower and its ability to fulfill its financial obligations.
<b>Currency swap</b>	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.
<b>Duration</b>	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.
<b>Government funds</b>	The Reserve Fund and the National Wealth Fund of the Russian Federation including their foreign currency deposits with the Bank of Russia (in US dollars, euros, and pounds sterling).
<b>Quantitative easing (QE)</b>	A monetary policy used by central banks to stimulate the economy. To carry out QE, a central bank purchases government securities or other securities from the market or provides funds collateralised by financial assets in order to increase money supply.
<b>Repo (reverse repo) transactions</b>	Securities sale (purchase) transactions with an obligation of their repurchase (resale) at future date at a stated price.
<b>Return on Bank of Russia foreign exchange assets</b>	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) returns of the portfolio to its market value as of the end of the previous day.
<b>SDR (Special Drawing Rights)</b>	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 four-currency basket made up of the US dollar, euro, yen, and pound sterling.