After the rally: Domestic factors to play a greater role in RUB pricing

We're upgrading our 3Q19 USD/RUB forecasts from 65-67 to 63-65, to account for the RUB2 rally which took place in mid-June on global risk-on, but in the near-term, we remain cautious due to the balance of payments seasonality. Local risks beyond 2019 include uncertainties regarding investing part of National Wealth Fund locally

Source: Shutterstock

231 bn

As expected

Minfin's FX purchases for July in roubles

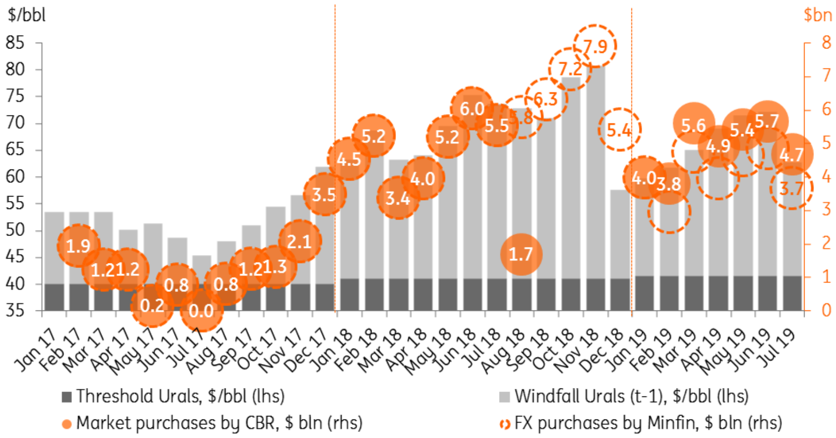
Down from RUB 310 bn in June

The Russian finance ministry announced it will spend RUB 231 billion (an equivalent of USD 3.7 billion) for FX purchases between 5 July and 6 August, as per the budget rule.

The amount includes the RUB 257 billion in extra fuel revenues of the budget expected in July and the RUB 26 billion downward revision in the extra fuel revenues for June.

Combine this with the August-December 2018 backlog, when the central bank put market purchases on hold, the total amount of FX purchased on the market will be $4.7 billion in July, down from the $5.7 billion seen in June. The decline in the FX purchases was expected and primarily reflects the nearly $10/bbl drop in the average monthly Urals crude oil price in June.

Monthly FX purchases by Russian Finance Ministry/Central Bank



Source: Bank of Russia, Finance Ministry, ING

The ministry of finance's FX purchases now should serve as a reminder to market participants of local RUB drivers following the global emerging market repricing that took place after the Federal Reserve's softening of communication. The externally-driven RUB appreciation to USD in the second half of June was around 2%, in line with that of RUB's emerging market peers. This calls for an adjustment of our near-term USD/RUB projections by RUB 2 - to 63-65 for 3Q19 and to 64 by the end of the year.

As can be seen, this doesn't cancel out some expected weakness in the coming months due to the seasonality of the balance of payments.

- We expect the Minfin/central bank FX purchases of around $15 billion in 3Q19 to sterilise around 75-100% of the $15-20 bln current account surplus, which in turn might be pressured by the summer holidays and ongoing dividend season (we expect custodians to purchase around $9 bln in favour of non-resident shareholders of the largest Russian dividend payers).
- In the meantime, the private sector seems to keep a high preference for the accumulation of international assets amid weak local capex growth. According to available data, net private capital outflow reached around $5 billion per month in April-May and may continue to do so. CBR is due to publish 2Q19 balance of payment data on July 8.
- The only support factor to RUB (and the channel of transmission of global risk-on/off to Russia) seems to be the inflow of foreign portfolio investments into the local state bonds (OFZ) of around $3-3.5 bln per month in April-May, which may have continued in June. However, the ability to maintain such strong inflows is now under question, as
  - foreign holders have restored their OFZ holdings close to historical high of $41 billion
  - Minfin has fulfilled around two thirds of the annual placement plan in 1H19 and is planning

to reduce primary supply to around $1.5-2.0 bln per month

We keep our 2020 expectations of further RUB depreciation to 68/USD given the persistent weakness in the capital account (accumulation of the international assets by corporates and the population) and the uncertainties related to the proposed investing part of the National Wealth Fund locally after 2019 (details on the proposal are outlined in our earlier note).

For now, we don't subscribe to the view expressed by some market participants, that the investment of NWF locally would necessarily result in return of some of the earlier accumulated FX back to the market, i.e. that the CBR will lower the FX purchases on the market. Unless officially refuted by the CBR and Minfin, we do not exclude a scenario, under which the FX purchases on the market will remain unchanged in line with the budget rule, while the conversion of FX into RUB for the purposes of investments would be done through internal transaction between Minfin and CBR with unchanged CBR international assets and increased supply of roubles on the money market.

Here's why we think there are no direct requirements for the central bank to adjust its current FX purchasing practice:

- The accumulation of FX under the budget rule is logically and legally separated from decisions as to where and how to invest the accumulated funds, ie, investing part of NWF locally does not reduce the amount of FX needed to be purchased by Minfin throughout the year
- The budget rule specifies only the actions of Minfin, not the CBR – i.e. it does not matter for Minfin whether the FX is purchased directly from CBR or on the market
  It is up to CBR to decide whether it wants to mirror the FX accumulation on the market (as confirmed by last year's decision to postpone purchases of some $30 bln until 2019-2022)
- CBR Governor Nabiullina indicated during the press conference that even though the CBR reserves have reached the comfortable $500 bln level, the CBR intends to keep accumulating FX reserves in line with the budget rule
- Regarding the CBR's approach to FX purchases, we should mind the 2018 situation when in the two-way flows to NWF, the CBR only respond to the accumulation part
  i.e. budget-rule mandated accumulation of NWF by RUB4.2 trillion was accompanied by the market purchases, while the simultaneous NWF spending of RUB1.1 trillion to finance the deficit of the State Pension Fund was not accompanied by any selling of the FX by the CBR on the market.

Read why weak Russian activity is starting to impact budget policy

> Overall, we believe it's too soon to make conclusions on the volumes and mechanics of the National Wealth Fund investments, as the discussion is clearly still in the early stages.
>
> However, the uncertainties related to the potential changes in the approach to the management of the state savings justify cautiousness regarding the long-term RUB trends.

Author

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("**ING**") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

 ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit http://www.ing.com.