

Why the ruble could be facing another bad August

Although new US sanctions on Russia are more or less symbolic, we do not see much relief in August, a statistically unlucky month for the ruble. Our key near-term concern is that portfolio inflows into OFZ may now slow due to the global risk-off sentiment and reduced new supply, as the Finance Ministry is close to fulfilling its annual placement plan early



A worker checks Russian 1,000-ruble banknotes at the Moscow Printing Factory

Clarification on US sanctions suggest the Friday panic was an overreaction

First, the good news: Russia's country-specific risk has not increased.

When the US Presidential executive order authorising sanctions on new issuances of Russian sovereign debt went out on Friday (details [here](#)), some market participants were worried that this Skripal-related action would include a ban on US financial institutions participating in any new debt placement by Russia (including OFZs, local currency bonds) and state-owned enterprises. However, the OFAC (US Treasury) clarification that followed over the weekend suggests the ban covers only new sovereign USD-denominated Eurobonds (while non-USD Eurobonds are OK unless it's a primary placement). You can read the full comments by the US OFAC [here](#).

Other sanctions on the list include a ban on financing assistance to Russia from international organisations, and a 'presumption of denial' to export dual-use chemical and biological items to Russia. Get the full details on that [here](#).

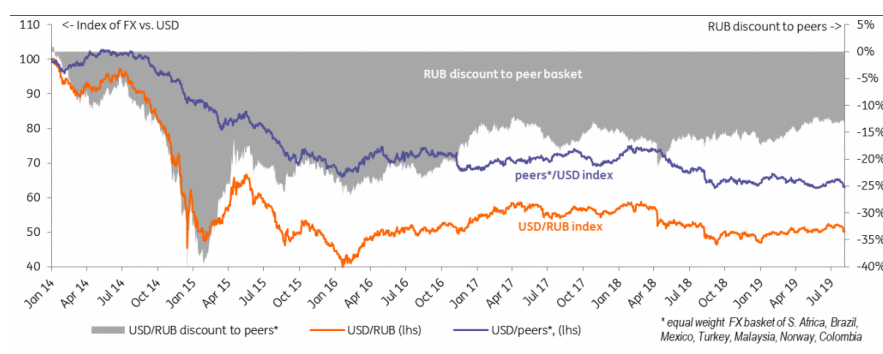
The clarifications from the US Treasury and State Departments make this action more or less symbolic, as other options on the Chemical and Biological Warfare Act menu included a ban on US participation in the OFZ placement, a cessation of US-Russia trade and a ban on Russian airlines crossing US borders. This should provide some relief for the Russian market in the short term. The scale of recovery should not exceed the Friday move on the initial news which is around 50 kopeks to USD (RUB depreciated to USD by 1.4% on Friday vs. 0.6% average drop in RUB's EM peers). The upside to the Russian FX and FI market might still be limited by the current risk-off mode in global markets due to US-China trade tensions. However, Russian instruments should now be more defensive than their EM peers.

Longer term, the risk of the US tightening its sanctions grip on the Russian market remains

Longer term, the risk of the US tightening its sanctions grip on the Russian market remains, especially given that several bills (DASKAA, DETER, 2020 Defense budget), calling for tighter sanctions against Russia, are still under discussion in the US Congress. It's worth noting that the Russian Central Bank was included in the sanction list, albeit in the softest way possible – by banning new USD-denominated foreign debt, which is irrelevant, as the CBR has north of USD500 bln worth of assets, mostly non-USD. Still, this is the first time the Central Bank of Russia has been mentioned in a US sanction-related action. Other countries where the central bank is sanctioned (though in a much more severe form of ban of any US transactions) include Venezuela, Nicaragua, Iran, and Syria.

On the positive side, the risk of further painful sanctions is not increasing, at least in the short term. The political think-tank Eurasia Group indicated that the recent action by the US administration will likely satisfy Russia hawks in Congress, which should lower the chance for a push for tighter sanctions in the near term. As a result, the RUB's discount to its peers, which we see as a proxy for the market perception of the sanction risk, should remain stable going forward at around 13% (see the chart below).

Performance of RUB and peers vs. USD



Source: Bloomberg, ING

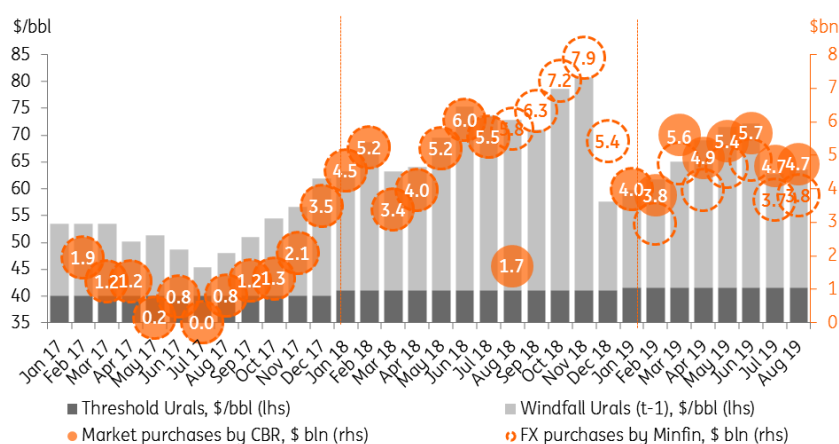
Local corporate flows balanced

From good to more neutral news and, indeed, the local corporate flows seem neutral for RUB in the short term.

Today (Monday), the Finance Ministry announced \$3.7 bln (under the current FX rate) in FX purchases within the budget rule, which is in line with expectations. Combined with the backlog from 2H18, when the Bank of Russia put market purchases on hold, the overall FX interventions will total \$4.7 bln, in line with the previous month. According to our estimates, that should sterilise around 80% of the current account surplus, which should stay \$5-8 bln per month in 3Q19. The remaining 20% of the surplus could easily be channeled into FX assets by the corporate sector, in line with previous behaviour.

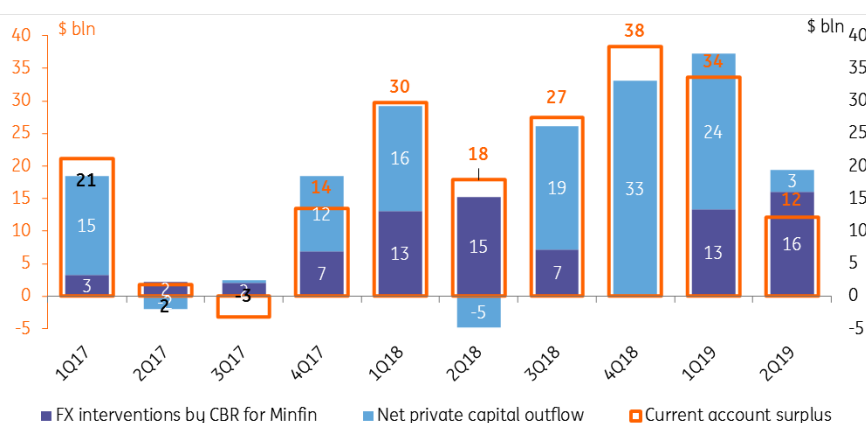
One interesting observation is that so far RUB has largely ignored the dividend payout period (May-Aug), during which around \$9 bln could have been transferred to non-resident shareholders of Russian corporates. Based on the recent news it seems that the dividend outflows might have been partially offset by the \$5 bln inflows coming from Sberbank's sale of its Turkish subsidiary. However, flow-wise the effect should now be exhausted. Therefore, future RUB performance should remain dependent on the portfolio flows.

Monthly FX purchases by Russian Finance Ministry/Central Bank



Source: Bank of Russia, Finance Ministry, ING

Current account sterilisation (corporate flows)



Source: Bank of Russia, ING

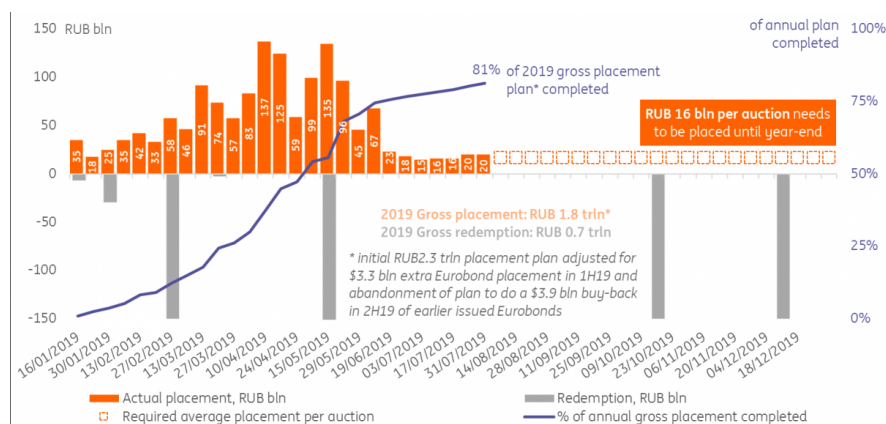
Portfolio inflows to OFZ should decelerate

Finally, the bad news: portfolio inflows to OFZ cannot be seen as very reliable.

First, the recent escalation in the US-China trade tensions is an important reminder that the global risk sentiment is rather fragile.

Second, the supply of OFZ available for non-residents to purchase is now limited. While the nominal OFZ placement plan suggests around RUB0.8 tr yet to be placed until the year-end (RUB38 bln per auction), this sum should be cut materially to account for above planned Eurobond placement of \$3.3 bln in 1H19 and the abandonment of the plan to do a \$3.9 bln buy-back in 2H19 of earlier issued Eurobonds. As a result, the remaining sum to be placed in OFZ should be around RUB340 bln, or RUB16 bln per auction till the year-end. This means that the Finance Ministry is unlikely to lift the primary weekly supply limit from the current RUB20 bln in the foreseeable future which, in the absence of an active secondary OFZ market, should limit monthly portfolio inflows at \$1.0 bln in the coming months vs. \$1.5-3.5 bln per month in March-June.

OFZ placement progress in 2019



Source: Finance Ministry, media, ING

Expecting USD/RUB 63-67 range for 2H19, year-end 64 target remains

Since 2000, there were only four cases when the ruble appreciated against the USD in August (2005, 2006, 2016, 2017), and the portfolio flow picture does not look supportive this year either. For now, we maintain our end of quarter target of 65.0 for 3Q19 and 64.0 for 4Q19. However, the increased nervousness of global markets may contribute to higher RUB volatility in the RUB 63-67 range in 3Q19. For now we still believe in another 25 bp CBR rate cut in September, unless there is a more severe deterioration in the market conditions. The December cut appears much less likely.

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