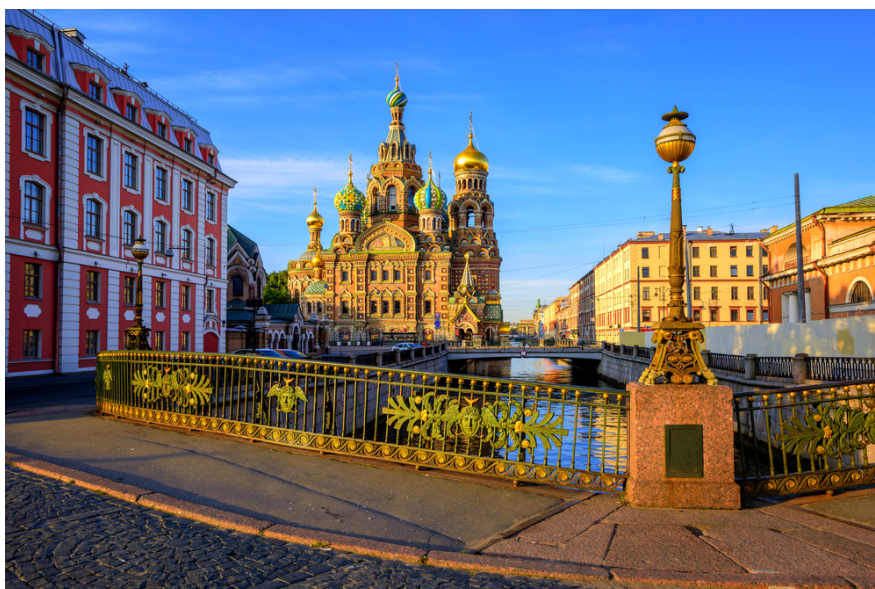


Russian balance of payments weakens, but don't worry

The Ministry of Finance's adjusted fiscal rule will reduce dependence on oil prices in 2018, so capital flows will be even more important for the rouble's outlook than ever before



Source: Shutterstock

\$22.6bn

BoP surplus in 2017

vs \$8.2bn in 2016

Stronger balance of payments in 2017

According to the CBR flash Balance of Payment (BoP) estimate for 2017 (and 4Q17), the current account balance (C/A) rose to US\$40.2bn from US\$25.5bn in 2016 which was fully a function of stronger goods exports.

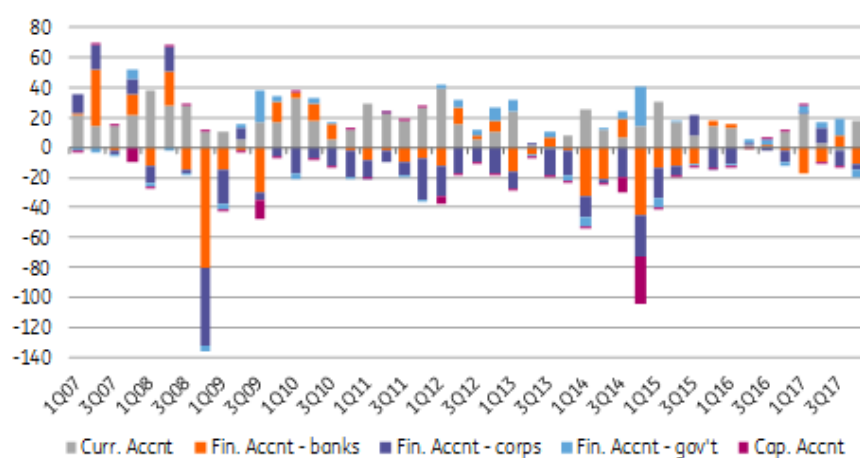
Energy exports rose from US\$154bn to US\$195bn on the back of higher oil prices and expanded supply of natural gas, while non-energy exports also surged from US\$128bn to US\$158bn. All other

C/A components like services, trade and balances in labour, investment and secondary incomes have all deteriorated in 2017 in comparison to 2016 due to the economic recovery and stronger domestic demand.

The financial account (F/A) had a deficit of US\$21bn vs US\$11.9bn in 2016 which looks natural under the floating RUB and higher C/A surplus. The biggest component of the F/A - private capital flows - saw a wider gap too of US\$31.3bn vs US\$19.8bn in 2016. The errors and omissions line improved significantly to US\$3.8bn from -US\$4.6bn in 2016.

All this made the overall balance of payments significantly stronger in 2017 at US\$22.6bn vs US\$8.2bn in 2016.

Key Balance of Payments components (US\$bn)



A bag of mixed 4Q17 trends

In 4Q17, the C/A balance of US\$17.8bn came as a material upside surprise both to our forecast of US\$10.5bn and Bloomberg consensus of US\$11bn. Its improvement from -US\$2.5bn in 3Q17 stands within the usual seasonality, but it was also clearly supported by a substantial rise in oil prices with Brent averaging US\$61.5/bbl vs US\$52/bbl in 3Q17.

However, it is worth mentioning that non-energy exports continued to outperform the energy ones rising by 28.5%YoY in 4Q vs 21.7% in the energy items.

On the other hand, imports kept growing by 22%YoY to US\$67.6bn reflecting the continuing growth of the domestic demand. The latter bodes well with a narrative that the economic growth weakness seen in October and November last year might be temporary, and GDP growth could accelerate over 2018 to around 2% as our current base-case forecast assumes.

Services trade gap improved in 4Q17 to -US\$8.1bn vs -US\$9.6bn in 3Q, while it widened vs the 3Q16 print of -US\$6bn on rising services imports in all major components (travels, transport and others) due to the stronger economy. As for other C/A items, the narrowing in the negative investment incomes balance (due to better performance in non-bank sectors) went against the usual seasonality and supported the C/A balance.

If moving to the F/A side, the balance shifted to -US\$22.1bn in 4Q17 vs -US\$7.1bn in 4Q16 and

US\$10.2bn in 3Q17 reflecting the higher C/A surplus. The decent deterioration was mostly driven by banks (-US\$10.4bn) and public sector (-US\$5.6bn) which overcome some improvement in the non-bank sector (-US\$4.4bn). Hence, the sharp acceleration of private capital outflows to US\$14.8bn in 4Q17 vs -US\$1bn in 3Q17 and -US\$9.8bn in 4Q16 doesn't look incredibly surprising.

In terms of key observations in the F/A trends in 4Q17, we noted (1) a significant drop of foreign demand for public debt to US\$1.2bn vs US\$7.3bn in 3Q17 likely reflecting the rising concerns over the extension of the US sanctions to the sovereign level and some RUB concerns; (2) acceleration of the deleveraging on the non-public sector side with external liabilities falling by US\$8bn vs US\$4.1bn in 3Q17, but this still looks OK given the CBR estimates assumed around US\$25.7bn of external debt payments in 4Q17, or US\$17.7bn without intercompany debt; (3) banks took US\$3.9bn from the CBR to cover their needs in FX liquidity in 4Q17 after a steady repayment of FX funds in previous quarters; (4) grey capital flight, that is usually approximated by a sum of "fictitious operations" and "errors&omissions" lines, turned into inflows of US\$1.6bn vs -US\$5.7bn in 4Q16 and -US\$1.3bn in 3Q17, which reflects both the structural decline of these outflows due to CBR banking sector clearing process as well as the fear of sanctions.

What to expect in 2018?

One may assume that the 2018 outlook will still depend on the oil price dynamics, but the link will be weaker than in 2017 given the changes in the fiscal rule.

The growth in oil prices and, thus, stronger C/A surplus will be mostly absorbed by higher FX purchases from the Ministry of Finance, which will now depend only on US\$/bbl oil price. The remaining "net" C/A surplus, assuming the RUB won't diverge significantly from fair level estimates, could be frozen near US\$17-20bn, which would serve as a cushion against other components of the capital flows less sensitive to oil prices.

The risk of extended US sanctions may indeed reduce portfolio inflows. But it may also produce some capital repatriation back to Russia of those who fear personal sanctions (e.g. the idea of special US\$ bonds for wealthy individuals and MinFin preferences for them vs foreign investors within the US\$3bn of planned sovereign issuance) as well as a lower demand of the private sector for foreign assets.

Hence, we still think the BoP will remain mostly balanced in 2018, even though some QoQ swings are possible, which may drive some RUB fluctuations due to market factors.

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