So, what's behind the rouble resilience?

The strong balance of payments explains the RUB resilience, not only to oil price volatility but also to external market. But support from the government may reverse soon

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The Central Bank of Russia (CBR) has published its flash Balance of Payments (BoP) estimate for 3Q17. Here are the things we find interesting.

1 Positive surprise to the current account balance

The current account balance was reported at USD 1.2bn versus our forecast of -USD 3.7bn and consensus of -USD 2.9bn, which looks like a positive surprise after CBR monthly estimates for July and August were at -USD2.5bn. The upgraded 2Q17 print from -USD 0.3bn to USD 2.8bn did flag upside risks for 3Q17, but not on the scale in the release.

2 Domestic demand drives energy exports

A major positive is that the current account resilience was partly driven by rising non-energy exports versus weaker energy ones in 3Q17. Yet, the rebound in imports covered the upside. Other C/A items followed the usual quarter-on-quarter seasonality with rising deficits in services trade and labour incomes, but a narrowing deficit in investment earnings. We look at 4Q-rolling totals to trace the trends, and here we have improving energy exports covering a widening gap in other C/A components, driven by domestic demand recovery.

3 FX sale from Reserve Fund likely

The financial accounting (F/A) balance stayed positive at USD 9.5bn vs USD 2.3bn in 2Q17 and -USD 11bn in 1Q17. But government and CBR operations worth net USD 10.3bn (USD 5.7bn and USD 4.6bn) made the story, which is still hard to fully reconcile at the moment, given:

(i) the USD sovereign debt swap in September assumed net inflows of only USD2.7bn.
(ii) the Ministry of Finance bought about USD2bn from the market over 3Q17.

There was probably some FX selling from the Reserve Fund to cover the budget gap and possible delays, with full recognition of the USD debt swap playing some role.

4 Capital flight acceleration or reconciliation problems?

The private sector capital flow balance was -USD4.9bn vs USD0.9bn in 2Q17. We note that: (i) non-financial sector debt was unchanged, i.e., the corporates were still able to roll over USD13bn of debt excluding intercompany loans, and (ii) corporates FDI balances turned negative to -USD4.1bn in 3Q17 vs USD4.4bn in 2Q17.

Finally, the net errors & omissions item stood at -USD4.2bn vs USD2.7bn in 2Q17, under a mostly unchanged -USD0.5bn print for dubious operations – grey capital flight seems to have accelerated sharply to USD4.7bn in 3Q17 vs an inflow of USD2.1bn in 2Q17. However, this may simply reflect some problems with reconciliation at this stage, and the figure may change after the revision.

What does this all mean?

Generally speaking, the positive BoP balance despite the swings in the C/A and F/A balances continues to explain the RUB resilience, not only to oil price volatility but also to external market trends. However, if we exclude the effects of the government and CBR operations, then we would see a steady deterioration in the net figure of the C/A and private capital flows.

In 4Q17 - 2018 the government and CBR impact will be defined by higher MinFin FX buying vs net flows at the Central Bank of Russia side in providing and absorbing FX liquidity. In 2018 the adjustments in the MinFin budget rule (for a detailed discussion see our note from 27 September) will drive higher FX demand from the MinFin side. A positive is that any reliable Oil and RUB scenarios this would still take only a portion of the expected C/A surplus, but QoQ swings in the C/A balance will leave RUB highly conditional on the capital flow balance.

Fortunately, we don't see any major turnaround here as

(i) foreign demand for OFZs/local assets will likely stay firm (given the CBR will likely continue cutting its key rate in 4Q17- 2018), and the next story to play could be the overly-high terminal rate of 2.5-3%

(ii) the external debt deleveraging story looks fully manageable from the banks/corporates side.

> However, we expect 2018 to witness net private capital outflows, so the RUB won't likely have any visible and sustainable upside even at current oil prices, and may even gradually weaken beyond 60/USD if oil prices fall to below US$50/bbl. Lastly, the strong RUB for longer will further weigh on the C/A balance, putting additional pressure on the RUB to readjust.