Russia Balance of Payments: increasingly reliant on portfolio inflows

The only reason for the rouble's 6% appreciation to the US dollar in 1Q19 was the US$7.5 billion gross portfolio inflows into the state bond market, as Russia's expectedly strong current account was fully offset by the government and the private sector's preference to accumulate international assets

Source: Shutterstock

$32.8bn

Better than expected

1Q19 current account surplus

vs. $30.1bn in 1Q18

1Q19 current account expectedly strong...

Russia's current account surplus of US$32.8bn in 1Q19 came in slightly above our US$32.0bn expectations and US$31.0bn consensus. The key observation is that the negative effect of the weakening non-oil exports growth (flat YoY in 1Q19 vs. a 14% increase in 2018) is offset by the positive effect of weakening merchandise imports (-3% YoY in 1Q19 vs. a 5% increase in 2019). The latter, while being positive for the current account surplus, is an indirect sign of softening investment activity, as 45% of Russia's merchandise imports (2018 data) represent investment and intermediary goods.

Provided oil prices remain at the current levels and the non-oil exports and overall import trends continue, the seasonality of the trade balance, debt servicing expenses, dividend payments and other non-trade items should result in the shrinking of the quarterly current account to US$12-18bn in 2Q and 3Q19 each.

$25.2bn

1Q19 net private capital outflow

incl. $28.9bn increase in foreign assets

Higher than expected

...and fully converted into foreign assets by the local private sector and the government

At the same time, the strong current account did not find its way into the Russian economy, as the local banks and other sectors accumulated US$28.9bn of international assets, which was the key component of the net private capital outflow of US$25.2bn seen over this period. This figure is very close to the US$30bn we expect for the entire year. While supportive of Russia's positive net investment position, the large outward investment flows are also a sign of weak local corporate demand for capital.

The accumulation of the international assets by the government, ie, budget rule-mandated FX purchases, totalled US$13bn, and as a result the rate of current account sterilization by corporate capital outflows and FX interventions went up from 67% in 1Q16 to 87% in 1Q17, 97% in 1Q18, and 118% in 1Q19.

Based on seasonality, the private current account should be close to zero in 2Q and 3Q19, while the FX purchases should total around US$15-18bn per quarter.

Portfolio flows - key factor for RUB

With the current account surplus balanced by the accumulation of foreign assets by corporates and the government, the importance of portfolio flows to the FX market increases. The 1Q19 data suggests that the last three months were a success. The government sector saw gross portfolio inflows of US$7.5bn, including the placement of US$3.0bn Eurobonds, which was bought predominantly by non-residents, and the return of non-residents to the OFZ market at a US$4-5bn scale. Those flows were the key reason behind the RUB appreciation by 6% to USD, outperforming its EM peers.

In the coming two quarters, RUB performance will be increasingly dependent on both the global risk appetite and Russia-specific newsflow, mainly on sanctions, which means a potential increase in volatility vs. a more clear direction seen in 1Q19. Meanwhile, we reiterate our expectation of USDRUB range of 65-67 for 2-3Q19, based on balance of payments fundamentals and seasonality.

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