Russian de-dollarization: Minfin joins in

The Russian Finance Ministry announced plans to lower the share of USD in international savings from the current 40% to make it more aligned with the FX structure of Bank of Russia's international reserves, where USD accounts for around 24%. We believe this rebalancing may be done without involving the local FX market

The Russian Finance Ministry announced plans to lower the share of USD in its savings, which is currently at around 40%, over the course of 2020. The targeted USD share has not been explicitly stated, but the structure of Bank of Russia's (CBR) international reserves, where USD accounts for 24% (as of end-1Q19, the latest disclosed date) was indicated as a proxy. We have the following thoughts on the matter.

- **The government is willing to join in on the de-dollarization trend observed elsewhere in Russia**. As we mentioned in our report Russian de-dollarization: banks on-board, others need convincing, over the course of the last 6 years the Russian government kept a stable share of USD assets at around 40%, lagging behind the central bank, which cut its USD exposure by 20 percentage points, similiar to de-dollarization of exports; commercial banks reduced their USD foreign assets by around 10 percentage points, mirroring the de-dollarization of foreign debt.
- **Current move is triggered by geopolitics.** The new US sanctions, effective in August 2019,

ie, the ban on US entities' participation in new placements of the Russian sovereign USD-denominated debt was the most recent catalyst. With no new USD-denominated debt in the pipeline, it makes less sense to maintain USD assets, subject to potential sanctions risks.

- **Minfin will need to sell $31 bn of USD, EUR, GBP by year-end 2020, and buy $68 bn of gold, CNY, JPY and other currencies...** As of 1 November 2019, the Minfin had liquid FX assets in the amount of $138 bn (official liquid portion of NWF plus the FX accumulated during the current year on separate accounts - to be incorporated into NWF in mid-2020), distrubuted in a 45/45/10 proportion among USD, EUR, and GBP - all depositied with the CBR. In our calculations based on the current budget projections, this sum will increase to $175 bn by the end of 2020. In order to approximate the FX structure of that sum to the last known structure of the CBR reserves, the Minfin should sell by the end of 2020 $20 bn of USD, $9 bn of EUR, $2 bn of GBP, and instead purchase $32 bn of gold, $25 bn of CNY, $7 bn of JPY, and $4 bn of other currencies.
- **...which will be an off-market transaction with the CBR.** On top of the Minfin's FX deposit, which partially funds CBR's international reserves, the CBR has its own international assets, which as of November 1 2019 totaled $403 bn, according to our estimates. Assuming the FX structure of CBR reserves has not changed materially since 1Q19, this sum would include $69 bn of USD, $100 bn of EUR, $24 bn of GBP, $108 bn of gold, $76 bn of CNY, $22 bn of JPY, $4 bn of other currencies - ie, the CBR's own reserves cover 3x the potential FX demand of its sovereign depositor. Therefore the Minfin's de-dollarization will not require the CBR to make any external transactions.
- **Minfin's de-dollarization does not automatically mean change in FX structure of CBR's FX purchases on the local market.** The question remains what will happen to the structure of market FX purchases that will continue in 2020 in accordance with the budget rule in the amount of $100-200 million per day. To remind, in order to fulfill the budget rule the Minfin does FX transactions only with the CBR, and it's the latter's decision whether and how to pass on those transactions into the local market. As a result, while it's clear that starting in 2020 the Minfin will cease purchasing USD, EUR, and GBP from the CBR, it is unlikely that the CBR will be able to do the same on the local market. According to CBR data for 1H19, 83% of the local FX market average daily turnover (total equivalent of $47 bn) is in USD, 17% in EUR, and other currencies' share is negligible. That structure somewhat mirrors the structure of trade flows, which despite the de-dollarization progress, are still USD-heavy. According to our estimates, this year's net trade inflows into Russia will total $190 bn in USD vs. just EUR10 bn in euro and virtually zero net inflows in other non-RUB currencies. As a result, while some adjustments to the currency structure of daily FX purchases are possible, we believe the CBR will maintain a presence in the most popular segments - USDRUB and EURRUB - subsequently exchanging them on the external market, according to the Minfin's more diverse needs.

Pending the commentary from the CBR, we do not see immediate implications of the 2020 de-dollarization of the Minfin's FX assets for the local market, because

1. The CBR's own reserves are large and diverse enough to fulfil the Minfin's potential demand for gold, CNY, JPY, and other currencies
2. Local FX market has only USD and EUR to offer for the CBR's FX purchases, and these are likely to continue, with subsequent conversion on the external markets.

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