

## Russian rouble: obstacles to full recovery remain

USD/RUB's 4% recovery from the pre-US election lows puts the Russian currency closer to fair value, which we see in the 70-75 range, assuming stable oil prices and foreign politics. However, obstacles to this recovery include lingering uncertainty over the US election, the risk of increased oil supply, and, most recently, lower than expected FX sales



Source: Shutterstock

### Rouble has recovered from recent lows, still undervalued

During the first trading day after the US election (3 November) and a Russian national holiday (4 November), the rouble is showing a strong 4% recovery compared to the US dollar, partially recovering the 5% losses suffered in the previous week. We believe the rouble has been recently supported by a number of factors, including:

- The generally [favourable](#) reaction of global markets to the US elections despite the lack of

a 'blue wave'

- A recovery in the oil price back to the \$40-45/bbl range after a brief period of slipping to \$35-40/bbl. This recovery seems to be driven not by the US election result, which has yet to be announced, but rather by a material drop in US crude oil [inventories](#) and a reiteration of OPEC++ countries' commitment to strict compliance with the deal
- The removal of additional demand for FX by local households - the latter might have been propelled by speculation in the national media that US elections and a likely Democrat victory would inevitably result in RUB depreciation.

At the same time, despite this recovery and the rouble's outperformance vs its peers in recent days, the currency's discount to other emerging markets and commodity currencies remains elevated - at around 14% by our estimates, which is a 19-month high (Figure 1). This means that currently, the market exchange rate is pricing in a deterioration in the country-specific context for the rouble either on the macro or on the foreign policy side, which we find hard to justify at this point:

- Russia's fiscal position has indeed deteriorated this year, with the budget breakeven likely to have jumped to \$80/bbl, the liquid FX portion of fiscal savings limited at around 7% of GDP and public debt jumping to around 20% of GDP. That said, this still appears stronger than most of its EM/commodity peers. Fiscal stimulus is at a moderate 4% of GDP and 2021-23 fiscal guidance points to likely [consolidation](#).
- Russia's monetary policy has indeed become more dovish, however relative to peers it remains [mid-range](#) in terms of both the nominal rates trajectory and real rates gauge. The current central bank communication suggests a low likelihood of Russia entering into negative real rates territory, unlike some of its peers. The central bank's direct involvement in the FX market has been limited by the operations of the Finance Ministry, and the overall international reserves are close to \$600 billion, nearly 40% of GDP, which is also high by global standards.
- Foreign policy risk is indeed the weak link in Russia's investment case in the eyes of international investors. Moreover, developments in recent months, including political instability in Belarus and the chemical poisoning of a local opposition leader, combined with the increased likelihood of a vocally more Russia-hawkish US president, has resulted in the RUB discount widening by 6ppt since mid-year. At the same time, recent newsflow suggests that fears of Russia's military involvement in Belarus and tough EU sanctions towards Russia have not materialised. The US view on foreign policy, especially in a contested domestic policy environment is indeed a source of uncertainty for Russia, however the tightening of US sanctions in 2016-2020 (against Rusal, Renova, US-denominated Eurobonds) suggests that the risk of sanctions does not fully depend on the occupant in the White House.
- The Russian balance of payments, though structurally weak due to low local confidence, has shown signs of [improvement](#) in 3Q20 on the capital account side - through lower accumulation of foreign assets by the non-financial corporate sector.

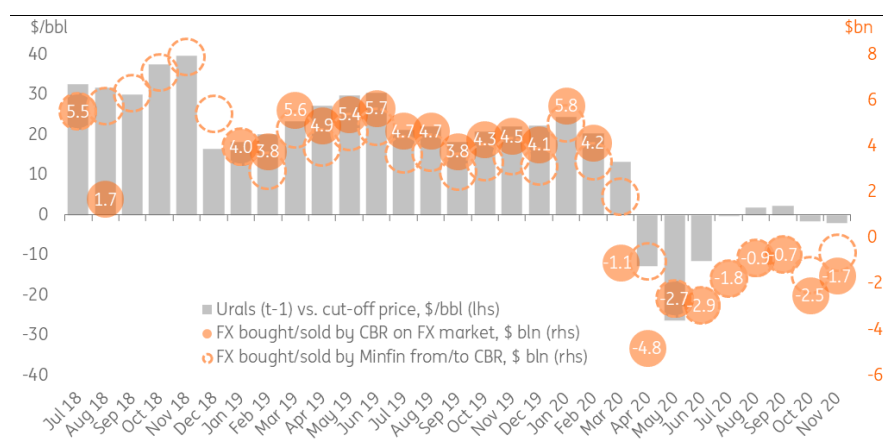
Based on these local considerations and on ING's [reiterated expectations of USD weakness](#) on the global market, we remain constructive on the rouble, targeting a return of USD/RUB to the 70-75 range in the medium term, which we see as close to fair value based on monetary aggregates.

That said, we do acknowledge that our constructive medium-term view on the rouble could be

challenged. In the best case, it could result in increased near-term volatility, while in the worst case it could fail to reach the targeted range entirely. Here are the main potential obstacles and risk factors:

- Part of the risk is related to the global view on risk. As suggested by our team of international economists and strategists, the contested outcome of the US election is resulting in short-term uncertainty and may lead to heightened volatility in the EM space. Also, the lack of a Democrat clean sweep suggests a higher risk of contested decision-making going forward, including on the much-awaited fiscal stimulus. And while a Biden presidency is considered to have positive implications for global trade, this administration is also seen as more likely to remove sanctions against Iran, which would be negative for oil prices and for the sustainability of the OPEC++ agreements in the longer-term.
- On a more Russia-focused note, the support to the FX market from FX sales in November seems to be lower than expected. The announced RUB 50bn (\$0.6bn) of sales are significantly lower than our RUB 106bn expectations and the RUB120bn Refinitiv consensus. This is due to higher than expected fuel revenue collection for October. Even accounting for the extra FX sales, related to one-off transactions with Sber and Aeroflot, total FX sales will total around US\$1.7bn in November, which is lower than the US\$2.5bn seen in October and expected by us for November. Importantly, the variable MinFin portion of FX sales is determined based on the previous month's data, which means that October weakness in the rouble took place despite stronger than expected fuel exports and high FX intervention, while in November the support to RUB from the trade balance and FX intervention could be lower.
- Broader balance of payments remains an uncertainty. The central bank is to release October numbers for the current account and private capital flows on 11 November. Meanwhile, based on daily data on the bond market, it appears that foreign portfolio investments into OFZ were volatile last month, with inflows of around RUB 45bn in the first half and up to RUB 35bn of outflows in the second. On the positive side, with MinFin nearly fulfilling the quarterly placement plan by now, fears of supply overhang should subside. However, foreign demand could also be constrained by uncertainty regarding foreign policy.

**Figure 2: FX sales to drop in November, unexpectedly**



Source: Finance Ministry, Refinitiv, Bank of Russia, ING

At this point it appears that our constructive medium-term view on the rouble is holding

ground, which however does not exclude the risk of high volatility and underperformance in the near-term due to lower than expected FX sales in November and volatility in portfolio flows. We are planning to fully update our view on the rouble next week, after the dust from US elections (hopefully) settles and the Bank of Russia provides its monthly assessment of the balance of payments on 11 November.

## Author

### Dmitry Dolgin

Chief Economist, CIS

[dmitry.dolgin@ing.de](mailto:dmitry.dolgin@ing.de)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.