Russian rouble's insulation through FX sales continues to decline

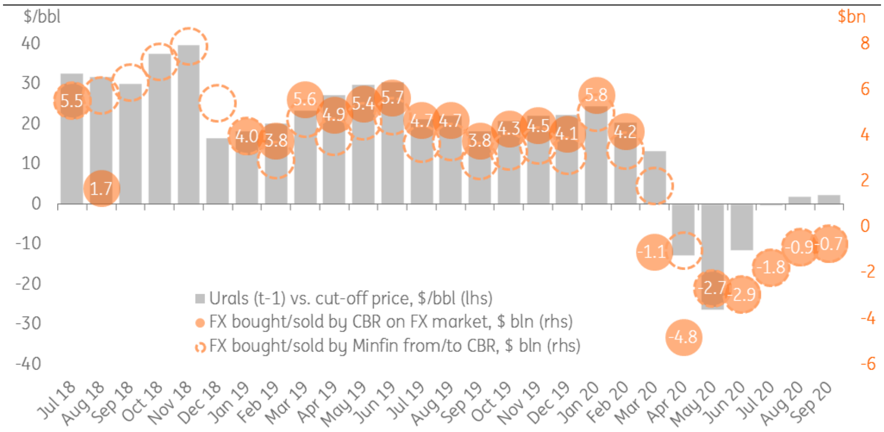
The CBR is to reduce FX sales from $0.9bn in August to $0.7bn in September, confirming that the rouble will be less insulated from capital flow volatility. We continue to expect the currency to stabilise within the 70-75 range by year-end on expected USD weakness and residual RUB 185bn FX sales in 4Q. However, foreign policy challenges are the obvious risk

Source: Shutterstock

The Russian finance ministry announced that it will cut the volume of FX sold to the Central Bank of Russia (off-market transactions) from RUB 65bn ($0.9bn) in August to RUB 54bn ($0.7bn) in September (Figure 1). This is in line with our RUB 55bn expectation. The continued decline in FX sales is explained by higher expected fuel revenues thanks to the increase in the monthly Urals from $44/bbl in July to $45/bbl in August amid unchanged oil output in September vs. August as per OPEC+ commitments.

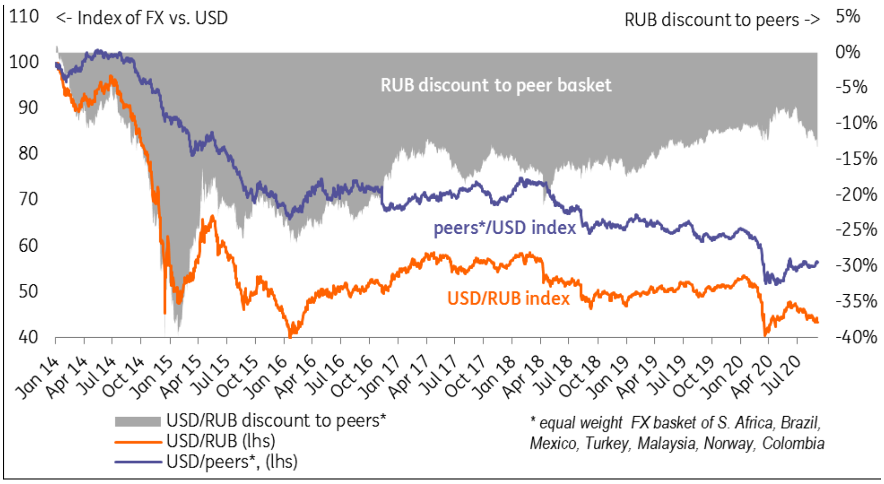
- As we explained previously, FX sales continue despite Urals exceeding the $42.4/bbl cut-off level, as the significant cut in oil output has resulted in below-expected oil revenues. Also, the CBR should fully realise the FX sales guided by the Ministry of Finance on the local market, as the previous spending and purchase backlogs have been netted out, and the residual $2.5bn of FX sales attributable to the one-off transaction with MinFin will be evenly spread through 4Q20. This means that, all else being equal, monthly FX sales should double from $0.7bn in September to around $1.5bn in October-December.
- We reiterate our take that the reduction of the CBR's presence in the FX market is positive in terms of transparency. However, in practical terms, this means that the rouble is less insulated from local capital outflows as well as volatility in portfolio flows. As a reminder, the acceleration of local capital outflows, combined with weakness in the current account, has contributed to the rouble's weakness since July, while in August-September, Russian assets have come under additional pressure due to the political crisis in Belarus and poisoning of Alexey Navalny, a Russian activist and opposition leader. This, combined with the most recent statements by German officials, may have further worsened the implied country risk perception. As a result, the rouble has materially diverged from its peers since the end of June, with the discount widening from under 8% to 13% currently, the highest reading since April 2019 (Figure 2).

Figure 1: FX sales continue to shrink gradually



Source: Finance Ministry, Bank of Russia, ING

Figure 2: RUB has underperformed its EM/commodity peers since July on local balance of payment and foreign policy challenges



Source: Bloomberg, ING

For now, we reiterate our constructive take that the seasonality of the 4Q balance of payments, the likely increase in FX sales, combined with global US dollar weakness, should allow USD/RUB to settle in our long-standing 70-75 range. However, given the intensifying negative foreign policy newsflow, it appears that there are high risks of volatility this month, and that any increase in the non-resident participation in the local state debt market (OFZ), which has stagnated since June, would be challenging in the near term.

September events will be crucial in determining the prospects of the mid-term RUB view:

- The August balance of payment assessment, to be released on 9 September, would indicate whether the current account remains near zero, and whether there is any improvement in the resident capital flows.
- The meeting between the presidents of Russia and Belarus, which could take place next week, may hint at the role Russia is willing to take in resolving the political crisis in Belarus. A mediation in the local political transition would most likely be neutral (our base case), while more active participation, push for integration, and confrontation with the EU might cause additional nervousness in the market.
- The development of the chemical warfare story would also bring more clarity as to whether it will result in new EU/US sanctions, and if so, whether they would be personal and targeted (least market-sensitive, as it was with the Skripal poisoning case), or more damaging to the market (such as the ban of foreign participation in the local state debt placement), or could endanger the Nord Stream 2 gas pipeline project.
- Announcement of the updated budget draft for 2020-2022 could give a better idea of the potential state debt supply, which would be relevant to the OFZ market. In addition to the political concerns, the market has been under pressure due to expectations that MinFin has to boost its annual gross placement plan from RUB 2.3tn to RUB 4-5tn this year (actual placement so far is RUB 2.2 tn). However, we do

not exclude that this number could be lower due to potential underspending and the ability to tackle the Treasury accounts.

- The updated three-year monetary policy guidelines to be released on 10 September may shed more light on the CBR's view of recent changes in the global monetary policy rhetoric and the increase in market volatility.

In any case, the recent market volatility, combined with a likely acceleration of the CPI in August and a faster-than-expected consumer recovery make the case against a cut in the key rate at the forthcoming CBR meeting on 19 September.

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