Russian de-dollarisation

Public-private divergence persists

Russia has been on the frontline of the de-dollarisation efforts for several years, recently supported by China. Over 2014–19, the share of USD dropped by 15–20 percentage points in Russia's trade and financial flows. In 2020, the push for de-dollarisation continued from the top, with the Finance Ministry catching up with the central bank on diversification of international assets. However, the politically driven de-dollarisation of state assets and foreign debt was low-hanging fruit. Russian households and corporates need to see a trustworthy alternative to USD before any material de-dollarisation of private sector trade and finance can be achieved.

- Russian external trade has continued to de-dollarise in 2020, in line with 2013-2019 trends, though largely a reflection of lower oil prices putting pressure on USD exports. Russia-China trade is the only area where de-dollarisation is more pronounced through a shift in oil contracts from USD to EUR. Since 2019, there have been no new milestones in terms of oil exporters switching from USD to EUR or RMB but given the global trade and foreign policy challenges China is likely to remain Russia's ally in de-dollarisation.

- Chinese de-dollarisation means an increased role of the national currency, promoted also through the Belt and Road initiative and China's diversified exports, making it different from Russia which is juggling between various reserve currencies. At least part of China's motivation to de-dollarise is political (to reduce US foreign policy risks), like Russia. Full or fast de-dollarisation is challenging in China due to structural obstacles, such as the non-liberalised balance of payments.

- Russian foreign debt continues to be actively de-dollarised, as maturing USD liabilities are being replaced by EUR and RUB. This is seen equally at the corporate and governmental level and is unlikely to be reversed any time soon given the persistent sanctions preventing the largest entities from USD borrowing. Another area of active de-dollarisation is the government's savings, for the same reasons. This year, the Finance Ministry swapped a portion of USD collected in 2019 as part of a fiscal rule to purchase SBER from CBR, and called for further dilution of USD, EUR and GBP in favour of gold.

- Meanwhile, the de-dollarisation of CBR reserves stopped as, following the active post-sanction de-dollarisation of 2018, the share of USD there is already low, at around 20% vs a stable 60% globally. It is worth noting that the share of USD in global SWIFT transactions has remained relatively unchanged at around 40% in recent years, highlighting the USD's stable footing at the international level, so far.

- The area most challenging to de-dollarisation in Russia is private assets, as there has been no inclination to decrease USD among banks, non-financial corporates and households. It seems that the Russian private sector continues to trust USD and is willing to sacrifice yield and face sanction risk in doing so. As a result, despite the drop in oil exports, USD trading volumes on the local FX market have even recovered in 2020. Increased trust in the local currency and the emergence of a sustainable alternative to USD at a global or regional level remain the pre-requisites for progress in this area. Otherwise, Russian financial stability will remain exposed to the risks related to sanctions (USD) and the euro area banking sector stability (EUR).
De-dollarisation still on the agenda locally

De-dollarisation in Russia has been in the focus of the business community over the last six to seven years. This report is an update to our first de-dollarisation overview from September 2019. This time, we decided to put the Russian de-dollarisation into a global context. This includes China’s experience on the matter, covered by ING’s Iris Pang, and some facts about the role of the US dollar in global international reserves and transactions.

On Russia, we have again gathered information on the evolution of the role of USD in the Russian economy since the end of 2013 until the latest available reporting dates. Some of the released data has been delayed this year because of the pandemic.

Most of the data on Russia is official statistics coming from the Central Bank of Russia (CBR). The two exceptions are: (1) The FX structure of local bank loans and deposits (we extrapolated the data from IFRS reports of banks accounting for 50-60% of FX deposits and 70-80% of FX loans) and (2) the FX structure of non-equity international assets by non-financial corporates and households' for 2013-14 (the FX structure is inferred from the available data on the overall volume and the contribution of FX revaluation effects in the growth). There is still no available data on the FX structure of the non-financial sector’s international equity (direct and portfolio) assets. As a result, our analysis covers around 80% of Russia’s international assets and 50% of its international liabilities.

De-dollarisation in Russia is running out of low-hanging fruit

The Covid-19 pandemic seems to have little effect on the main de-dollarisation trends in Russia. Based on the available 2020 data and adjusted for the statistical effects related to exchange rate fluctuations, the drop in the role of USD continued in trade flows (as the drop in oil prices leads to lower USD-denominated exports), foreign debt (the persisting sanction pressure leads to gradual replacement of USD-denominated foreign debt with EUR and RUB), and state savings (as the Finance Ministry is catching up with the central bank, helped by the dilution of the National Wealth Fund with RUB equity).

De-dollarisation of other USD assets proved more of a challenge, as the role of USD in the central bank’s reserves is already low at c.20% vs. and far below the global average of c.60%; and the private sector is not as eager to de-dollarise as the state. In fact, there was a slight recovery in the role of USD in bank deposits and the FX market turnover in 2020 in Russia. Meanwhile, the role of USD in global SWIFT is stable.

Fig 1 Role of USD in Russia: evolution as a share, 2013, 2019, and 2020, adjusted for exchange rate moves


Source: Bank of Russia, Russian Customs, Finance Ministry, KUAP.RU, ING,
While the net inflow of US dollar into Russia via the trade channel is now lower than in the previous years, it is still at a significant annualised amount of US$118 billion in 2020, preventing a material de-dollarisation of financial flows and FX market turnover.

Exports: lower oil price – lower share of USD

Russian exports continued to de-dollarise in 2020, with the share of USD dropping by 2ppt to 60% in nominal terms, and by 3ppt to 49%, adjusted for the FX revaluation effect. This is largely a reflection of lower oil prices rather than anything else. In nominal terms, USD exports of goods and services this year will be around $80bn lower than in 2019, fully covered by the expected drop in fuel exports.

Russia-China trade is the only area where de-dollarisation is more pronounced, but there was no material change in the FX structure of Russian exports to China in 2020. We discuss China’s de-dollarisation later in the text.

A shift towards EUR and RUB in the FX structure of exports, earlier seen in trade with EU and India, is no longer pronounced.
De-dollarisation of imports stopped in 2020

The share of USD in Russian imports remained unchanged in 2020 both in nominal terms and adjusted by the exchange rate fluctuations. However, this is masking two contradicting trends. On the one hand, imports from the EU and China (accounting for 57% of Russia’s total imports) continued to de-dollarise in favour of EUR. The nominal share of the latter was up by around 3ppt in nominal terms in 1H20 despite the weakness in the EUR/USD exchange rate. On the other hand, imports from other destinations seem to have re-dollarised, suggesting limited scope for de-dollarisation outside the priority directions.
Chinese imports continued to de-dollarise in 2020, in favour of EUR, national currencies

RUB, the primary FX in imports with former USSR, did not gain more ground in 2020

*ING estimates based on 1H20 data

Source: Bank of Russia, Federal Customs, CEIC, ING
De-dollarisation in China

Introduction
With China promoting the use of the yuan as a payment currency, its share in both FX reserves and investment currency is slowly increasing. Even though this is a slow process, the use of the dollar may well decline.

Timeline
The yuan started on a path of internationalisation in 2009. It started with the use of the yuan as an invoicing currency of international trade and since then, the yuan has been increasing in other countries’ foreign reserves. From 2016, the yuan was included in the IMF's SDR basket. Last year, China opened up the capital account further, which attracted more foreign investors to invest in Mainland China’s onshore yuan assets. All of this means that the yuan has been replacing some dollar transactions in the world, albeit very slowly.

De-dollarisation starts with holding fewer dollars
Conflicts between the two countries are also speeding up de-dollarisation by promoting the use of yuan. The most obvious de-dollarisation that China has done so far is simply holding fewer dollars. Foreign reserves continued to rise after the peak of Covid-19 in China in February. But China did not buy more US Treasuries, in fact, it has held fewer US Treasuries since February. US Treasuries dropped to 35% of China’s FX reserves in June 2020 from 39% in August 2017.

Other countries hold more yuan in their reserves
According to the IMF’s COFER data, around $230 billion of global reserves were in yuan assets, up 8% in 2Q20 from 2Q19. This is around 1.9% of total global reserves, surpassing Canada’s 1.8% to become the fifth biggest reserve currency in the world.

Yuan as a trade settlement currency
In July 2020, the yuan as an invoice currency increased to 1.86% of global transactions from 0.03% in 2010 after the yuan had been an invoicing currency for a year, according to SWIFT. The market share as an invoicing currency is still very low. But there are some bilateral trade contracts that have used yuan for settlement. In May 2020, China’s Baosteel and Australia’s Rio Tinto Group completed a first transaction using blockchain for yuan settlement, which was worth CNY100 million, according to the People’s Bank of China. Overall, the share of yuan in foreign trade settlement went up from 5.5% at the beginning of 2012 to 15% as of August 2020.

The conflict between China and the US could escalate to a point where the US does not allow Chinese companies’ dollar transactions to be settled. That could push China to use yuan broadly to replace dollar transactions - a historic moment which could signal a big
leap in yuan settlement and de-dollarisation. That said, the option is in the hands of the US government.

**Yuan as a commodity trade currency**
Commodities are usually traded in dollars. But since 2013, China has also started trading commodities in yuan on its commodity exchanges. Now, China offers trading in crude oil, iron ore, Purified Terephthalic Acid (PTA) and natural rubber (TSR20) in yuan. Offshore traders can access these markets. More than 70% of the commodity trades from offshore traders were denominated in yuan whereas the rest were in dollar.

**Yuan as an investment currency**
There was a sizeable jump in foreign investors holding onshore yuan assets in 2019 due to the relaxation of policy. Offshore investment in onshore yuan stocks and bonds increased 48.6% in 2019. The outstanding balance of financial assets was CNY6.41 trillion as of 2019.

**The way forward**
With more sanctions from the US, China has had to promote greater use of yuan to avoid settlement in dollars. The US has effectively been pushing China to de-dollarise. Allies of China, including those in the Belt and Road initiative, will have more contracts with China denominated in yuan. Depending on allies alone is not going to be enough and China is expected to leverage international trade and foreign investments in yuan assets to increase the use of yuan. The process of increasing the use of the yuan and de-dollarisation is very slow. Unless there is an acceleration of exchange rate liberalisation reform and capital account reform, the use of yuan will only pick up gradually. In the meantime, bilateral yuan contracts will dominate the settlement market.

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Foreign debt: de-dollarisation continues

Russian foreign debt continues to be actively de-dollarised, as maturing USD liabilities are being replaced by EUR and RUB. This is seen at the corporate and governmental level (MinFin is no longer issuing USD denominated Eurobonds and switched to EUR placement this November) and is unlikely to be reversed anytime soon given the persistent sanctions and lack of appetite from US investors. Meanwhile, the EU’s foreign policy view on Russia following the 2H20 events seems moderate.

Fig 13  Russian entities continue to de-dollarise their USD foreign liabilities despite a relatively flat total foreign debt

Source: Bank of Russia, ING

Fig 14  USD debt is replaced with EUR…

Source: Bank of Russia, Reuters, ING

Fig 15 …and RUB liabilities

Source: Bank of Russia, Reuters, ING

Foreign assets – Finance Ministry to catch up

This year, the Finance Ministry managed to optically reduce the share of USD in its savings (National Wealth Fund) by 6ppt to 32% in nominal terms and by 9ppt to 22%, adjusted for the exchange rate fluctuations. This may seem an impressive result, however that came as a result of the purchase of a 50% RUB equity stake in SBER, the state’s largest bank, from the central bank – i.e. as a result of dilution of the liquid FX savings. The share of USD as a percentage of liquid FX savings remained unchanged at 45%, as per NWF’s investment memorandum.

Meanwhile, the Russian Finance Ministry is proposing to further reduce the share of USD by investing a portion of the sovereign wealth fund into precious metals. The potential rebalancing of fiscal savings will not require additional market transactions, as MinFin’s needs are fully covered by the large and diversified balance sheet of the central bank (as the liquid portion of the NWF is de facto an FX deposit with the central bank).
Russian de-dollarisation  December 2020

Fig 16  State savings see no de-dollarisation due to fiscal rule and NWF investment memorandum, but it may change soon

The proposed change in the NWF structure could be aimed at greater synchronisation with the CBR, which has been spearheading Russia’s de-dollarisation efforts since 2018. As a reminder, the Russian central bank materially reduced its USD holdings in 2018 in response to increased risks from the US OFAC, replacing USD with EUR, gold and RMB. As a result, the share of USD dropped to around 20-25%, where it has remained until now (the latest available data on the CBR reserve structure is for 1Q20), which is substantially lower than the relatively stable global average of 60%. The grounds for a lower share of USD in the Russian international reserves go beyond foreign politics given the EU-heavy structure of foreign trade and the growing share of China.

Fig 17  CBR actively de-dollarised in 2018, further room limited

Global context

Putting the Russian de-dollarisation in the global context, it appears that the central bank is a front-runner, as the share of USD in the global international allocated reserves declined only modestly, by 5ppt in the last five years, to a still high level of 61%. Moreover, the de-dollarisation trend was brought to a halt in H120, suggesting the stable preference for USD as a reserve currency during a period of risk-off sentiment in global markets. One explanation is that during the initial Covid shock, around US$450bn was used globally in Fed swap lines, confirming the essential role of the US dollar.

In addition, it appears that the USD’s role in global transactions remains relatively unchanged. Even though SWIFT indicated that in October 2020 the share of EUR
transactions exceeded that of the USD, for the first time since mid-2013, we attribute this move largely to the USD weakness in 2H20. The share of USD in SWIFT transactions has been relatively stable at around 40–42% since 2014, though given the development of competing European and Chinese rapid payment systems, the share of USD as a global transaction currency may still be challenged in the future.

Fig 18  De-dollarisation of global international reserves stopped in 2020

![FX structure of global international allocated reserves](image)

Source: IMF, ING

Fig 19  Share of USD in global transactions stable (adjusted for FX rate movements)

![Share of FX in SWIFT transactions](image)

Source: SWIFT, Reuters

**De-dollarisation of private assets remains a challenge**

The year 2020 proved that the biggest challenge to de-dollarisation is to convince the private sector to diversify away from dollar as the primary international and local FX asset. While de-dollarisation of trade, foreign debt, and CBR/MinFin assets appears to be helped by politics, the private sector needs more convincing, as it keeps converting the net inflow coming through the trade channel into USD assets. The obstacles to de-dollarisation include low trust in the rouble as a savings currency among businesses and wealthy households, and a relatively high yield in the USD relative to its main competitor.

Looking at the foreign assets structure, it appears that 2020 had no effect on the stable USD preference of non-financial corporates and households (regardless of the exchange rate moves and sanction concerns) and saw a rebound in the banks’ USD assets after four years of decline. As a result, the dollarisation of the private sector’s foreign assets is now aligned at similar levels, between 55-60% in nominal terms and 45-47% adjusted for the exchange rate fluctuations since 2013. The downside from this level appears uncertain.
The dollarisation of local assets is noticeably smaller, but the trends have also been stable in the recent years. Extrapolating the publicly available financial reports of the major banks, accounting for c.50-60% of the sector’s FX deposits and c.70-80% of the FX loans, we can conclude that despite the overall pressure on household income and the sharp RUB depreciation, households (around one third of them have savings) and corporates resumed accumulation of USD, having purchased around US$11 billion in 1H20 and maintaining the share of USD at 10-11% of the total retail and corporate deposits (net of exchange rate effects). Interestingly, the overall volume of FX deposits declined slightly in 1H20, and the share of USD in them went up to a seven-year high of 82% in nominal terms and 79% under fixed 2013 FX rates. Meanwhile, the exposure to FX loans and USD continued to decline, which is not surprising.

The slowdown in the de-dollarisation trend is also reflected in the 5ppt rebound of the USD share (to 87% in nominal terms and to 83% under flat FX rate) on the local FX market after three consecutive years of declines. Given the continued de-dollarisation of trade amid lower oil prices, this rebound seems to reflect the increased role of USD transactions in the financial flows.
Key takeaways

The de-dollarisation so far fully confirms our initial conclusions made in the pre-Covid-era:

- Further de-dollarisation of trade is possible along with a switch of the oil export contracts to EUR, as the key Russia counterparties, including the EU and China, are looking for ways to bypass the USD area. Without this, de-dollarisation of exports largely reflects the decline in the oil price.

- Foreign liabilities in USD remain first in line to be redeemed due to sanction risks and high interest expense relative to EUR. Foreign borrowing in EUR, RUB, and other FX appears more stable even if it is used only to refinance the existing debt.

- MinFin is about to catch up on de-dollarisation, as the liquid portion of the National Wealth Fund reached 7% of GDP, allowing for a bigger diversification of instruments. However, this is unlikely to have material implications for the market, as MinFin's de-dollarisation should be covered internally by the CBR's balance sheet.

- De-dollarisation of the real sector's FX assets remains the biggest challenge despite sanction risks and increased global pressure on USD amid an easing in the US fiscal and monetary policy, as the overall preference for FX savings needs to be addressed through higher local investment opportunities.
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