The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

CRISIS WATCH: We Are Getting Closer

By The Moscow Times

October 04, 2011



Russia is edging closer to a crisis as the Central Bank of Russia (CBR) has started to spend money to prop up the ruble, which has clearly started to devalue.

Last week the CBR reserves declined by $6bn since the start of September ending on Friday with $526bn. At the same time the ruble has continued to slide against the dollar and lost about 4% over the week, having lost about 14% since the start of the year.

This is very bad news as Russia has been enjoying a trade surplus this year and has taken in a total of $46bn YTD. This has been enough to rebuild the reserves back to about $540bn (up from crisis low of $320bn, but still down from pre-crisis high of $600bn) and also to replenish the reserve fund, which is (or rather was last week) expected to end the year with out $145bmn at the end of December.

The fall is driven almost exclusively by fear and the danger is now that the talk of a crisis will become a self-fulfilling prophesy. CBR Chairman Sergei Ignatiev (who hates talking to the media) was forced to go on record at the end of last week to promise that the ruble

corridor will not be abandoned and confirmed the band as 32.50- 37.50. The presser also came a day after finance minister Alexei Kudrin was sacked, which has only added to the uncertainty.

But analysts say the CBR's greatest intervention activity was on 23 and 26 September (both dates are beyond the recently released CBR report), where the central bank is estimated to have spent $4bn in these days alone in September.

Ignatiev also said there was no need to provide uncollateralized loans as the bank did in the second half of 2008, "which also reflects his optimistic view on the Russian banking system," says Natalia Orlova, the chief economist at Alfa Bank.

"In the event of improvement on global markets, we believe the CBR's strategy will be shown to have been fully appropriate. However, if more negative news comes, further CBR interventions will reinforce the local liquidity squeeze," Orlova said in a note on Friday. "While yesterday the ruble managed to bounce off the border of the CBR's currency band to RUB36.9 to the basket, that move was driven by a global correction after a weeklong market fall, and volatility is very likely to persist. Thus, even though uncollateralized loans are not required at the moment and the currency band appears sustainable, Russia will face more tension on the interbank and exchange rate markets if oil falls lower."

The spending also means that capital outflow has probably restarted after it slowed dramatically in the summer. Some $31bn left the country to August, but the recent bought of nerves means that capital flight has resumed and some people are now talking about a total outflow of $100bn for this year — at this stage, probably an overstatement.

As we said in our note last week, liquidity is drying up in the Russian financial markets due to the fear and even if Greece doesn't blow up in two weeks time these nerves are doing an increasing amount of damage to the Russian economy despite the fact that the basic economic fundamentals are unchanged.

Reserves are high — one of the highest in the world on both export coverage and GDP per capita bases — while the inflation forecast for the year was lowered to 7.3% for 2011, its lowest level since 1991. The current account remains in surplus and the Finance Ministry also ordered another $1.3bn pay off to Russia's external Eurobond debt last week. And so on - almost all the macro indicators are good.

You can see the hysteria building outside Russia. The BBC ran a story at the weekend claiming that "investors are fleeing Russia" thanks to "falling oil prices" when in fact neither of these things have happened. Investment, especially foreign direct investment, continues to recovery from the crisis lows and oil remains resolutely at about $100 per barrel. However, the currently levels of Russian equity valuations are pricing in an oil at about $75, which is where oil **could** go if there is a meltdown in western Europe.

With a price to earnings ratio for Russian stocks at below five, the valuations on Russian equity is "absurdly low," according to Mattias Westman, founder of Prosperity Capital Management. But that has not stopped portfolio investors rushing for the exit. Last week saw

another heavy sell off.

"Fund flows showed continued flight from risk and no appetite for risk assets this past week (22-28 September). Some inflows were recorded into gold in what we view as a flight to safety, but EM bonds and equity funds continued to post outflows," said Ovanes Oganisian of Renaissance Capital in his weekly fund flow wrap.

Russia equity-dedicated funds showed outflows of $443mn (the biggest outflow among all developing countries). Russian bond funds also recorded the largest outflows ($12mn) last week. Overall, Russia outflows from equities at a country-level were estimated at $578mn last week

But confidence is clearly fading fast. : The September Manufacturing PMI edged up to 50.0 from 49.9 in August, following two consecutive months in the contraction zone. The detailed breakdown reveals a continuing decline in employment, although at a slower pace (49.3). Input and output prices inflation softened (to 57.1 and 51.1 respectively).

"The September Manufacturing PMI reading indicates that the manufacturing sector is stagnating, dragged back by new orders and export orders," says Alexey Moiseev, chief economist at VTB Bank. "The combination of close to zero output growth, shrinking employment and abating inflation suggests that activity in the sector is indeed subdued. This is likely to feed into the official data on industrial production, which has recently been strong, with a 6.2% YoY increase in August."

Bank's are clearly anticipating trouble and have started to curb their personal lending — the very engine of growth for Russia's economy — to limit their exposure to non-performing loans, should there be another crunch.

"We are thinking how to scale down the credit expansion and don't want to run risks once again. But we are unwilling to frighten customers by such statements and announce it in public. Why should we be the first?" a senior manager at a top-20 bank was quoted by Kommersant as saying last week. "There are risks, of course. But we can scale down the granting of loans without any public statements. We don't have to explain reasons for a loan refusal," another banker is quoted as saying.

And even more scary in August, Sberbank had the right to a margin call on the 50.1% Novorossiysk Commercial Sea Port stake pledged for a loan due to the share price decline, Vedomosti reported. However, the share price threshold that triggers early redemption was not revealed, nor has Sberbank actually made its margin call so far. It was these margin calls that did so much damage to equity prices in the 2008 meltdown, although it should be noted this margin call is controlled by a Russian state-owned bank, which is bound to be a lot more forgiving, while the 2008 margin calls were controlled by foreign banks.

Will all this spin out of control? The liquidity in the financial sector is the key to the whole game and the CBR has already shown that it is willing to provide it where it is necessary. Moreover, the CBR has also shown (despite what Ignatiev says) that it willing to let the ruble slide if things get very bad, which should cushion the blow. And finally the one bright spot

in this otherwise gloomy news picture is that one of the reasons why liquidity has been tight is thanks to the annual tax collection season which sucks up huge amounts of cash came to an end on Friday.

The views expressed in opinion pieces do not necessarily reflect the position of The Moscow Times.

Original url: https://www.themoscowtimes.com/2011/10/04/crisis-watch-we-are-getting-closer-a35211