BALANCE OF PAYMENTS: JANUARY–JUNE 2016[1]

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The BOP (Balance of Payments) data show that a current account surplus contracted considerably in H1 2016 over the same period previous year. This is because there were serious cutbacks in exports while the decline in imports slowed down. Despite growth in non-bank sector's foreign asset holdings, there was a sweeping decline in net capital outflow in the private sector because banks and other sectors met their debt obligations at slower rate. As a result, the rouble appreciated as of the end of H1 2016, reaching a fundamentally substantiated level, although there are risks that it will depreciate.

According to the Bank of Russia's preliminary assessment of the BOP for January–June 2016, the current account balance stood positive at $15.9bn, down 66% ($46.5bn) over H1 2015. Such a considerable contraction resulted from a decline in the trade balance because exports declined at a faster rate than the contraction of imports of goods and services.

Exports of goods were down 29.7% in H1 2016 over the same period of 2015 (from $181.6bn to $127.7bn), including exports of crude oil (down 32.3% to $32.6bn) and natural gas (down 21.8% to $15.0bn) due to low global prices of energy-carrying resources. For instance, in H1 2016, the Brent crude was traded by an average of 31.7% below the price set in the same period of 2015. On the other hand, imports of goods dropped only 9.5% (from $92.3bn to $83.6bn) at the same period over Q1 2015 because the rouble gained 6% in real terms over December 2015 and the decline in aggregate demand slowed down (real wages declined by an average of 8.7% in January–May 2015, whereas the decline slowed down to -0.7% in January–May 2016). As a result, a positive trade balance contracted by 50.6% (from $89.3bn to $44.1bn) (*Fig. 1*).

A negative service balance, compensation of employees balance and investment income balance prevented the current account balance from contracting further in H1 2016. For example, a service balance deficit amounted to $9.9bn in H1 2016, down 44.5% (in absolute terms) over H1 2015: imports of services dropped 22.1% to $33.2bn mainly because the Russians continued to cut back on international travel expenses while exports of services fell 6.1% to $23.3bn.

In absolute terms, the compensation of employees balance dropped 69.7% to -$0.9bn (-$3.0bn in H1 2015). An investment income balance deficit was down 26.4% (from -$19.7bn to -$14.5bn) due to lower costs of servicing overseas debt obligations that were reduced. Investment income receivable dropped 7.3% (from $15.8bn to $14.6bn) due to contracting foreign asset holdings in the private sector. The income payable by non-financial enterprises decreased by 18.5% ($24.3bn). The income receivable by the banking sector increased from $4.2bn in H1 2015 to $5.3bn in H1 2016, resulting in an overall positive investment income balance of $1.4bn in the banking sector (it was negative ($0.5bn) in H1 2015).

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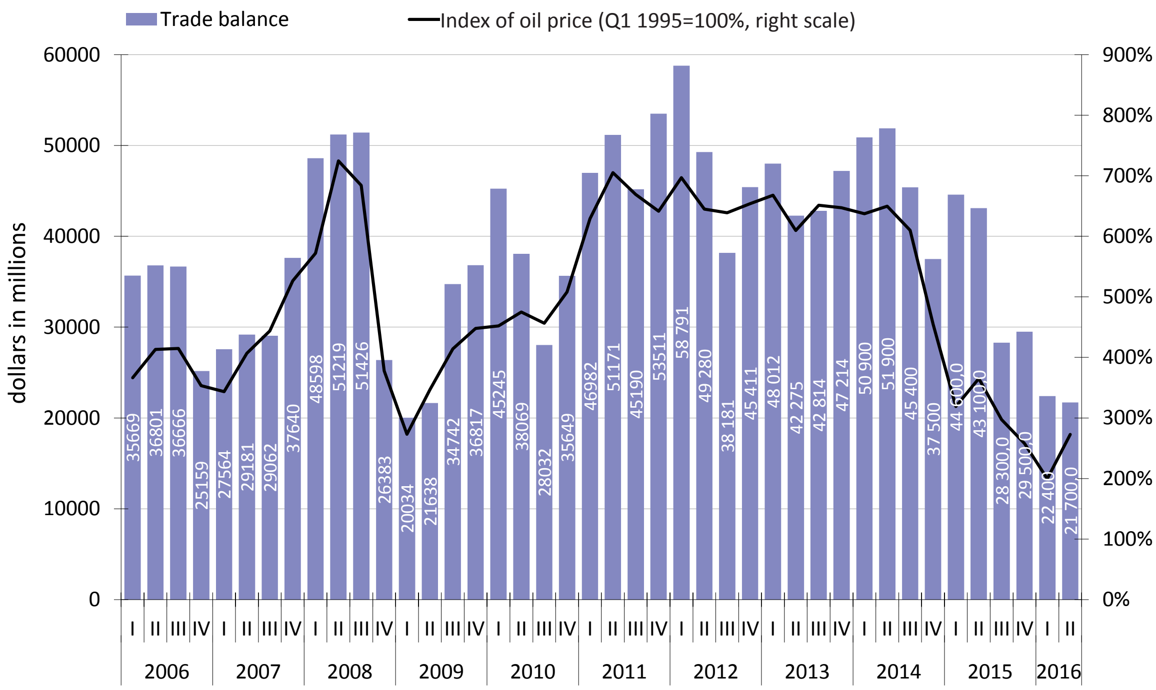


Sources: Bank of Russia, Gaidar Institute's own research.

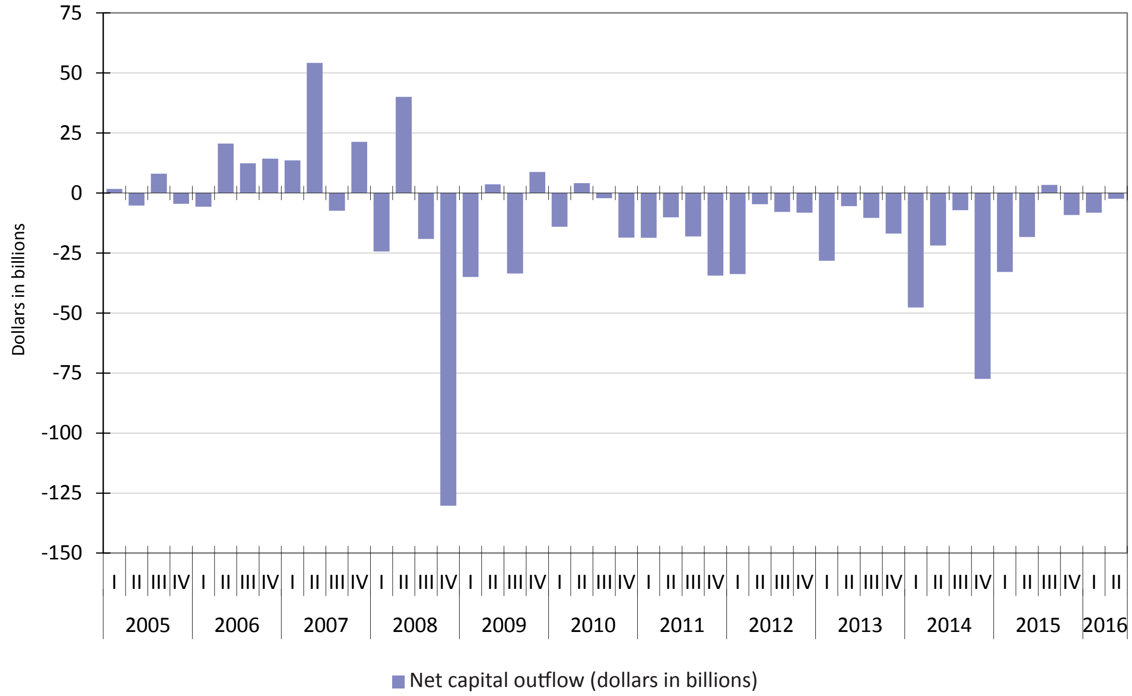
Fig. 1. Russia's trade balance and global oil price index in 2006–2016

The decline in BOP current account surplus was attended by a comparable contraction of the financial account deficit that stood at $4.5bn in H1 2016 (compared to $56.9bn in H1 2015). Russian economic agents' obligations to foreign economic agents were reduced by $3.2bn as of the end of H1 2016, whereas H1 2015 saw a decrease of $50.2bn in obligations to foreign economic agents. Furthermore, Q2 2016 saw an increase of $5.8bn in such obligations. In particular, banks reduced their overseas debt obligations by $12.0bn in H1 2016 (by $35.4bn in H1 2015) though repayments on previously accumulated debt obligations. By contrast, the non-bank sector increased their overseas debt obligations by $7.2bn ($8.7bn in H1 2015) through refinancing of a major share of their overseas debt obligations.

H1 2015 saw a foreign direct investment inflow of $2.0bn to the non-bank sector, while H1 2016 saw it increase to $6.5bn. Portfolio investment increased $2.4bn (down $0.8bn in H1 2015). Indebtedness under the item 'credits and loans" was reduced by $2.3bn compared to $10.6bn in H1 2015.

Note that Russian economic agents will have to pay $56.1bn on their overseas debt obligations in the period between July and December 2016. However, actual payments on the overseas debt obligations may be found to be less than scheduled. As a reminder, $37.1bn were actually paid in the period between July and December 2015 instead of the $62.5bn scheduled for the same period, due to intra-group payments and obligations that are very likely to be deferred or refinanced. Note that, according to the Bank of Russia, in Q3 and Q4 2016, non-financial organizations are to pay $17.8bn and $22.4bn, respectively, on overseas debt obligations, according to the schedule of payments. However, actual payments for the period may be found to be 38.2% and 4.0%, respectively, less than scheduled for the reasons given above.

The BOP data show that residents' foreign assets (foreign economic agents' obligations to Russian economic agents increased $1.3bn in the period between



Sources: Bank of Russia, Gaidar Institute's own research.

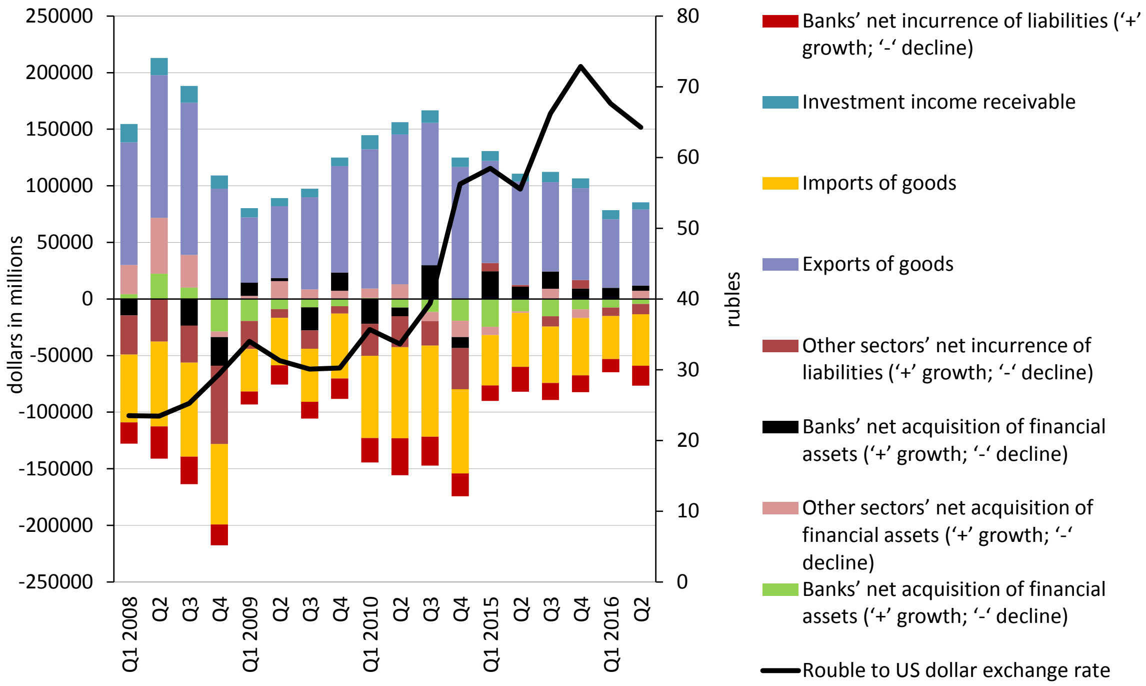
Fig. 2. Net capital outflow in private sector in 2005–2016

January and June 2016 (down $6.7bn in H1 2015). On the other hand, banking sector's foreign assets contracted $14.6bn (-$8.6bn in H1 2015). The foreign assets shrank partly due to banks' payments on foreign currency obligations to the Bank of Russia. Foreign currency liquidity received by credit institutions from the Bank of Russia dropped Rb 8.6bn in the period between January and June 2016. Capital exports from other sectors increased 14.7% to $16.5bn, of which direct and portfolio investments to foreign countries amounted to $12.2bn and $3.1bn, respectively ($9.1bn and $0.7bn, respectively, in H1 2015). Overall, net capital exports in the private sector stood at $10.5bn, which is five times below the value seen in H1 2015 (*Fig. 2*).

The BOP data show that Q1 2016 saw international reserves assets increase $7.0bn because the banking sector met outstanding foreign currency obligations to the regulator.

The data for January–March 2016 show that banks' assets increased $1.2bn as a result of foreign currency cash operations with non-residents (banks' assets decreased by $7.1bn during the same period of 2015). At the same time, banks' foreign exchange assets decreased by $1.9bn (an increase of $2.1bn in Q1 2015) as a result of selling/buying foreign currency in cash to/from individuals through exchange offices, as well as closing (opening) foreign exchange deposits through front offices. As a result, foreign currency in cash in hand increased $1.2bn to $41.5bn in the period between January and March 2016, according to the Bank of Russia. According to the BOP data, the non-financial sector transferred $2.8bn in foreign currency in cash to foreign counterparts in H1 2016 (compared to $6.1bn in H1 2015).

Thus, the current account's downward pressure upon the rouble due to a considerably declined positive trade balance in H1 2016 was offset by across-the-board cutbacks in capital outflow, especially in the banking sector (*Fig. 3*).



Source: Russia's central bank.

Fig. 3. Key sources of foreign currency supply and demand

As a consequence, the US dollar to rouble nominal exchange rate decreased by 11.8%, from 72.9 to 64.3 roubles per US dollar in H1 2016. As a reminder, the rouble was traded at 80 roubles per US dollar in the foreign exchange market in the second half of January 2016. With a stable inflation rate and a strengthening (in nominal terms) rouble, the rouble real effective exchange rate increased 6.0% in H1 2016 over December 2015, reaching the levels seen in the fall of 2015. Growth in crude oil prices and FX market players' positive expectations pushed the rouble up in H1 2016.

According to our research, the rouble real effective exchange rate is currently set at a fundamentally substantiated level[1] driven by the dynamics of total factor productivity, terms of trade, capital flows, government spending. Overall, this is the result of applying a market-based exchange rate formation mechanism, with no Bank of Russia interventions, economic agents' panic sentiment, FX market shocks.

Despite the rouble appreciation in H1 2016, there is risk that the rouble will depreciate following a possible fall in crude oil prices because substantial reserves of crude oil and refined petroleum products have been accumulated in the global market. Besides, the rouble may depreciate due to a budget deficit that may develop because of financing from the Reserve Fund and, consequently, liquidity surplus in the banking sector. However, banks may trade their Russian rouble holdings in the FX market if negative exchange rate expectations prevail.

1 According to our research, the rouble real effective exchange rate was slightly underestimated by 0.4% in Q1 2016, whereas it was overestimated by 0.7% in Q2 2016.