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RUSSIA AND THE GLOBAL FINANCIAL CRISIS

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RUSSIA AND THE GLOBAL FINANCIAL CRISIS

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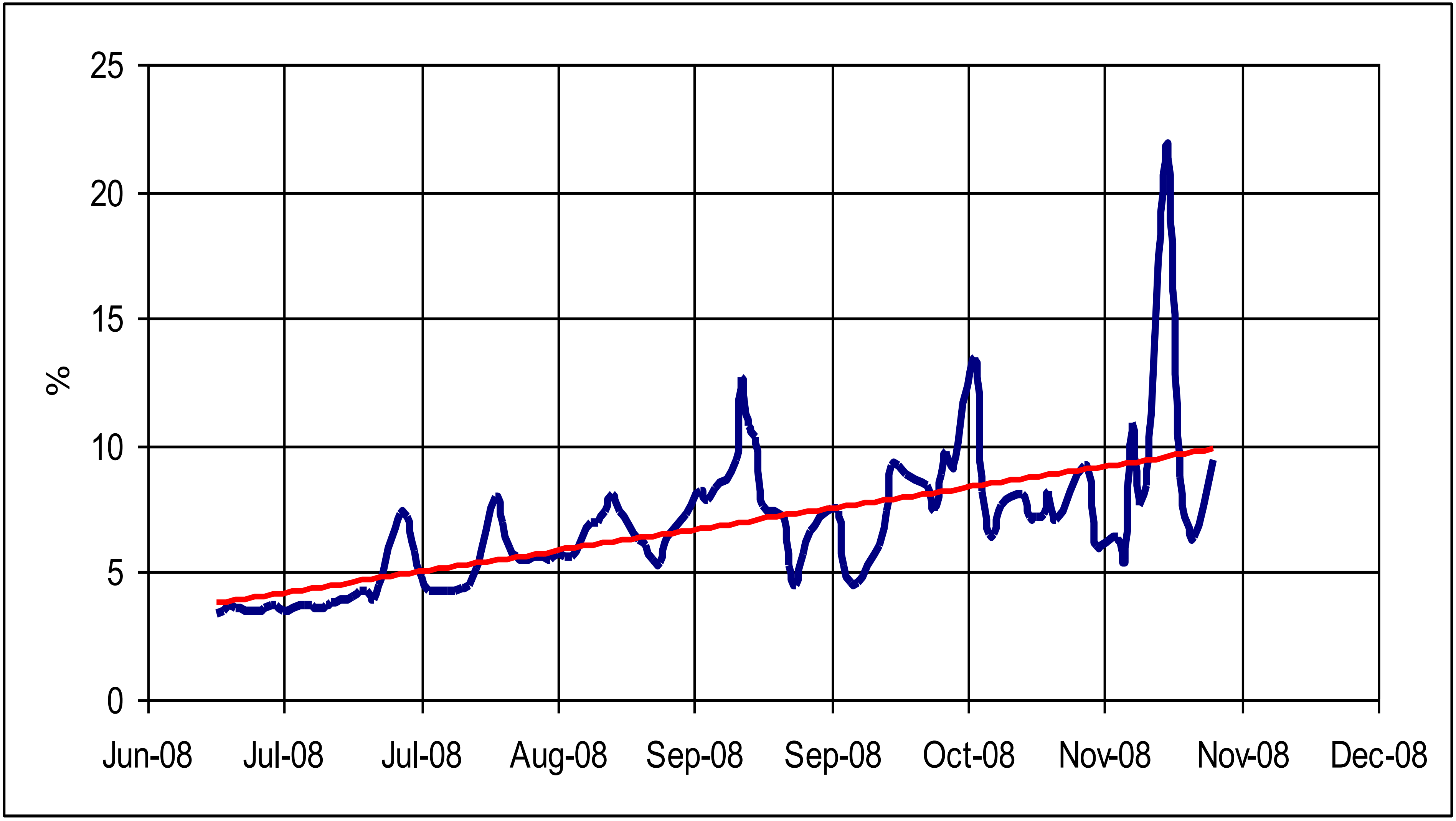
Credit market…

- The confidence in banks and of banks is diminishing, as is the flow of funds between them.
- In October the volume of bank deposits dropped by 6% (the largest drop so far) and the share of Russians with bank deposits fell from 32% to 25%.

Credit market

- Banks substantially reduced interbank lending, and lending rates increased (slide 4).
- The shape of the yield curve changed dramatically (slide 5).
- Yield spreads widened (slide 6).

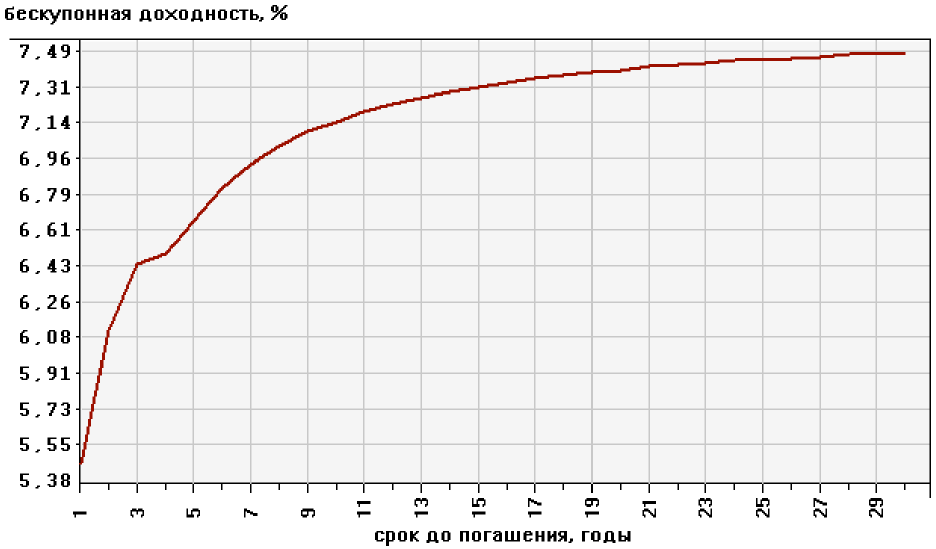
Moscow interbank actual credit rate (MIACR)



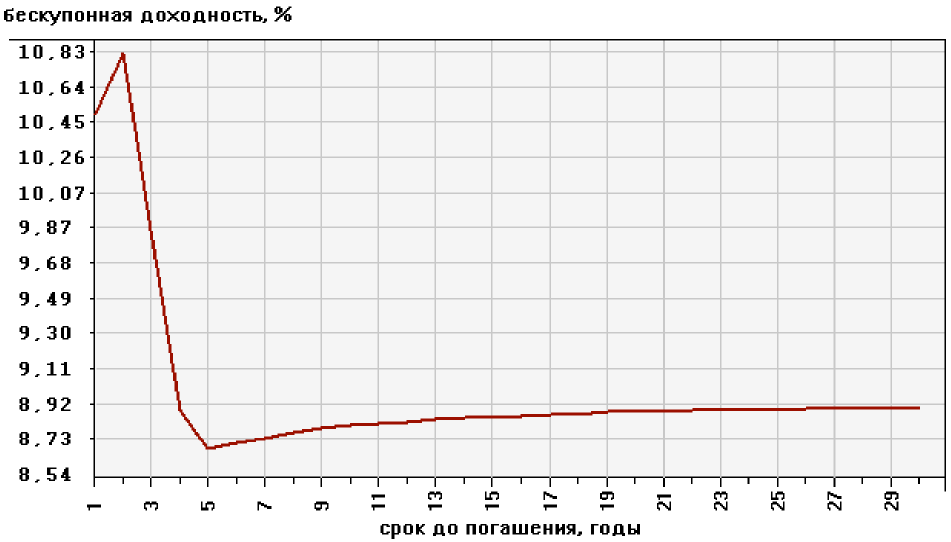
Source: Bank of Russia

Zero-coupon yield curve

July 1, 2008

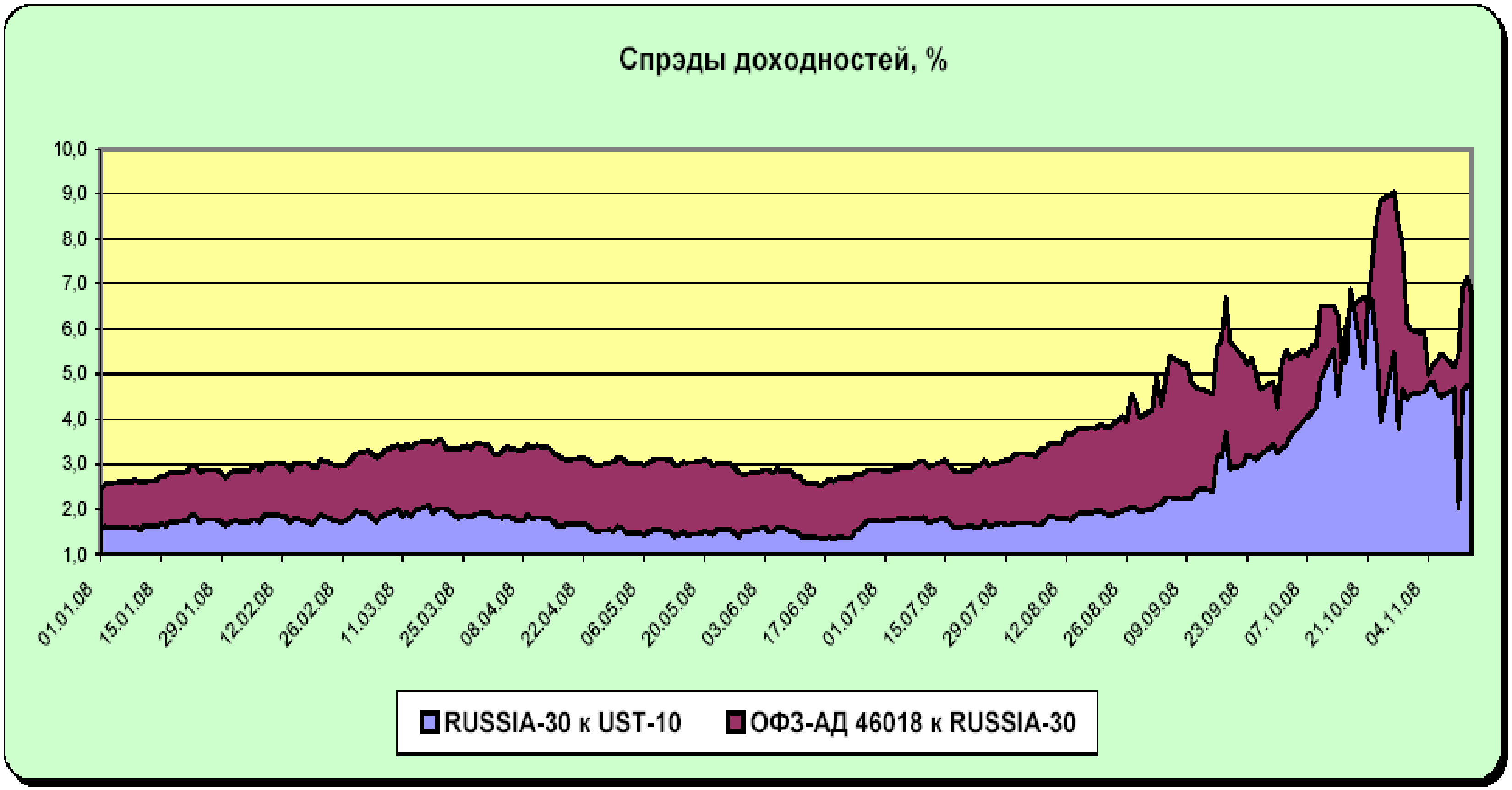


November 28, 2008



Source: Bank of Russia

Yield spreads



Source: Ministry of Finance

Stock market

- Russians saw tremendous volatility and near-collapse of their emerging stock market as oil prices dropped.
- Between May 19 and November 7 Russia lost 84% of her 2007 GDP in terms of market capitalization.
- In 2008 net capital outflow may reach USD 50 billion, in 2009 – twice as much (World Bank estimate).

Oil Bubble

Stock price index

RUB/USD

Source: MICEX

Government actions

- The government have taken a series of urgent, necessary, and temporary steps to limit further damage.
- These may be grouped as follows:
  - Liquidity provision
  - Bail-outs
  - Direct loans and claim buy-back
  - Contingent liabilities.

Liquidity provision

- To ease the liquidity problem, public funds are being channeled to the banking system through three state-owned banks under the Bank of Russia's supervision.
- The Bank of Russia (BOR) is lending money to commercial banks on unsecured basis by way of regular auctions.
- BOR is ready to lend to securities firms (non-depository institutions) but wants them to be subject to its prudential control.
- 18% of the National Wealth Fund is slated for investment in Russian "blue chips".

Bail-outs

- BOR was authorized to trade in stocks and corporate bonds. This authority may be used to bail out troubled banks.
- Vnesheconombank (VEB), a state-owned development bank, has already bailed out at least one major commercial bank – Globexbank (28^{th} largest in term of net assets).
- To support the emerging mortgage market, the government plans to “bail out” apartments (buy them from developers and resell to certain groups of population).

Direct loans and claim buy-back

- A recent law on additional measures for supporting Russia's financial system authorizes VEB:
  - to lend up to USD 50 billion to eligible firms to help them repay and/or service external debt incurred prior to September 25, 2008;
  - to purchase from foreign creditors claims under obligations incurred prior to September 25, 2008.
- BOR is depositing USD 50 billion with VEB for one year with an option to prolong the term.

Contingent liabilities

- The Federal Deposit Insurance Agency greatly increased insurance coverage. Between July and now the Agency's total liability increased from 3,7 trillion rubbles to almost 6 trillion.
- The government is providing credit and export guarantees to state-owned enterprises and major private companies.
- Regional authorities are not forgotten.

Public debt management…

- Ten years ago the government defaulted on it domestic debt. Lessons were learnt.
- Now Russia has:
  - Prudent debt structure (duration = 5 years , fixed-rate share = 88%, 62% domestic).
  - Streamlined market (mechanical issuance and reopening of a few benchmarks).
  - Transparent issuer (debt strategy, auction calendar, statictics).
  - Debt burden = 8% GDP.

Public debt management…

- High oil prices allowed to save some money now called the Reserve Fund (RF).
- RF is kind of a “good old” sinking fund made out of budget surpluses with the objective to pay down public debt.
- Now the government has:
  - RF = USD 135 billion.
  - Entire public debt = USD 106 billion.

Public debt management…

- Yet, the crisis is unfolding, and in 2009 more public money will be injected into the economy to curb damages.
- Public expenditures will grow and taxes will be cut. A budget deficit around 1% of GDP is very much in the picture.
- In September the government stopped borrowing. It will finance the expected deficit by depleting RF and cash balances.

Public debt management

- Lower cash balances may force the government to resume issuance of short-term debt (discontinued in 2002) and reduce issuance of long-term debt.
- Though a fixed-rate share will decrease and debt maturity profile is far from ideal, the risk of default on conventional debt is low as long as RF is at hand.
- The threat to solvency may come from mounting contingent liabilities. A new lesson to be learnt - how to manage cash and contingent debt.