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Research Report

Russia's international reserves and oil funds

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oil funds



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Heli Simola

Russia's international reserves and oil funds

Summary

Russia's international reserves decreased considerably in 2014, due in particular to the outflow of capital. The reserves are still relatively large and consist of liquid assets in accordance with international reporting practice. The majority of oil funds accumulated by Russia are part of the country's international reserves because they are controlled by the central bank, which has invested them in liquid foreign assets. This year, Russia has again started to tap its oil funds to compensate for the weakness of the economy. Because the assets have been drawn from the funds in roubles, this has not impacted the volume of international reserves.

Keywords: Russia, international reserves, oil funds

Russia's international reserves and oil funds

Russia's international reserves decreased considerably in 2014, due in particular to capital outflows. The reserves are however still relatively large and they consist of liquid assets because the reserves are reported in accordance with international practice. The majority of oil funds accumulated by Russia are part of the country's international reserves because they are controlled by the central bank, and the central bank has invested them in liquid foreign assets. This year, Russia has again started to tap its oil funds to compensate for the weakness of the economy. The assets have however been drawn from the funds in roubles, and so this has not had an impact on the volume of the international reserves.

International reserves

The IMF defines international reserves as external assets that are controlled by monetary authorities and readily available for meeting balance of payments financing needs, for intervention in exchange markets, and for other related purposes. At the end of March, Russia's international reserves totalled USD 356 billion. The international reserves are reported in accordance with IMF standards and so are made up of the central bank's gold reserves and liquid assets denominated in foreign currencies (at end-February, 85% of it was in the form of securities and the rest in cash and deposits) and special drawing rights (SDR) and the country's reserve position at the IMF (Table 1). Russia's international reserves also include the majority of the country's oil funds (the entire Reserve Fund of USD 76 bn, and USD 53 bn of the Welfare Fund at the end of March). They are reported as part of the international reserves because they are invested in liquid dollar-, euro- and sterling-denominated assets. The Bank of Russia controls and invests the assets as instructed by the Ministry of Finance, and therefore they are regarded as central bank assets. On the liabilities side of the central bank's balance sheet, they are recorded under government claims on the central bank.

Table 1 Russia's international reserves, bn USD

	1 April 2014	1 April 2015
International reserves	486.1	356.4
Gold	43.4	47.3
Special Drawing rights (SDR) and Reserve tranche in the IMF	13.0	10.4
Other international reserves, of which	429.7	298.7
Reserve Fund	87.5	75.7
National Welfare Fund	65.0	52.9

Sources: Bank of Russia, Russian Ministry of Finance.

In 2014, Russia's international reserves shrank by USD 125 bn, mainly due to a large outflow of capital. In January–March 2015, the international reserves continued to decrease, by nearly USD 30 bn; this was however largely due to exchange rate movements. Over USD 40 bn of foreign debt matured, but Russian companies apparently succeeded in renewing a part of it, because the preliminary balance of payment figures indicate that the net outflow of foreign liabilities was slightly

over USD 30 bn. As regards foreign assets, the inflow of capital slightly exceeded the outflow of capital. The current account posted a notable surplus.

In 2015, the Ministry of Finance has drawn RUB 500 bn (USD 8.3 bn) from the Reserve Fund assets and over RUB 200 bn (USD 3.5 bn) from the National Welfare Fund. Because the withdrawals have been in roubles, the ministry has sold currencies included in the international reserves to the central bank and has received roubles in return. Therefore the use of fund assets has not changed the value of the international reserves. The measures have only resulted in a decrease in the portion of Ministry of Finance assets in the international reserves.

Russia's public and private sector foreign debt will mature this year (April–December) in the amount of USD 100 bn, but nearly one-fourth of it is rouble-denominated. The level of public sector foreign debt is very low and so the majority of debt is private sector debt. Companies should be able to refinance part of their debt as in past months, particularly as one-fifth of the foreign debt is intercompany or similar debt. Moreover, many indebted companies also have some foreign assets. Russia's current account continued to post a clear surplus in the first quarter of the year, due to a sizeable decline in imports.

In line with current policy of the Bank of Russia, the rouble is, as a rule, allowed to float freely, and therefore the central bank has not intervened in the foreign exchange markets this year. In exceptional situations, the rouble exchange rate can still be supported via foreign exchange interventions. In such a situation, if the oil fund assets (which are part of the international reserves) were needed to stabilise the rouble, the Ministry of Finance could instruct the central bank to use fund assets also for this purpose, in the same way as the other parts of the international reserves are used. For example, in December 2014 as the rouble depreciated sharply, the Ministry of Finance sold some of its currency assets to support the rouble.

Oil Funds

In the past decade, Russia has been channelling tax revenues from oil and gas sales into funds. **The Reserve Fund** is used for supporting government finances when the economy is weak. The last time the Reserve Fund was tapped was during the 2009 crisis, but this year the Fund's assets will again be used for financing budget expenditures. **The National Welfare Fund** was established for financing pension expenditures, but during times of crisis – as in 2015 – it has been used to support the economy.

Reserve Fund

At the end of March, the value of the Reserve Fund was nearly USD 76 bn. The assets are on central bank accounts and are part of the international reserves. They are invested in dollar-, euro- and sterling-denominated liquid assets. This year, the Reserve Fund assets are used for covering budget expenditure. In January–March, RUB 500 bn (USD 8 bn) was drawn from the Fund, resulting in a corresponding decrease in Fund assets. The dollar-denominated value of the Reserve Fund reflects to some extent also exchange rate movements, as approximately half of the Fund consists of euro- and sterling-denominated assets (Table 2). The value of the Fund may also change slightly because of investment returns.

The government plans to increase the use of Reserve Fund assets considerably this year, because the deficit in the 2015 federal budget will be covered mainly by Reserve Fund assets. According to estimates by the Russian Ministry of Finance, the value of the Reserve Fund will total

RUB 2,620 bn¹ at the end of December 2015, compared to RUB 4,430 bn at the end of March. Even though the government plans to use a considerable amount of the Fund's assets, which are included in the international reserves, the international reserves will not shrink if the assets withdrawn are rouble-denominated, as before. The share of the Fund in the international reserves will however decrease because currency assets are transferred directly to the central bank.

Table 2 Russia's Reserve Fund, USD bn

	1 March 2014	1 April 2015
Total	87.5	75.7
USD	38.1	37.3
EUR	40.4	30.6
GBP	9.0	7.8

Source: Russian Ministry of Finance.

National Welfare Fund

The value of the National Welfare Fund was USD 74 bn at the end of March. Of that, USD 53 bn is invested in the same way as the assets of the Reserve Fund, i.e., in liquid dollar-, euro- and sterling-denominated assets controlled by the central bank and included in the international reserves (Table 3). These assets are thus readily available, if necessary. The rest (USD 20 bn) is invested in instruments that are not necessarily readily available. Approximately half of this sum is in fixed-term interest-bearing deposits at the state-owned development bank Vneshekonombank (VEB), and the deposits were made already during the economic crisis in 2009. VEB has reinvested some of the assets in lending activities, in accordance with government instructions (Table 4).

Table 3 Russia's National Welfare Fund, bn USD

	1 April 2014	1 April 2015
Accounts in the central bank	65.0	52.9
USD	24.6	21.4
EUR	33.1	25.2
GBP	7.3	6.3
Deposits in VEB	19.5	9.6
RUB	13.3	3.3
USD	6.3	6.3
Foreign government bonds (Ukraine)	3.0	3.0
Securities related to the financing of domestic infrastructure projects	-	3.1
RUB	-	1.9
USD	-	1.2
Shares of domestic banks (VTB, Rosselkhozbank, Gazprom Bank)	-	4.8
Deposits at VTB to finance infrastructure projects	-	2.2
Total	87.5	74.4

Source: Russian Ministry of Finance.

¹ The assessment is based on the federal budget for 2015 approved in April. It shows that in 2015, the budget deficit will be ca RUB 2,700 bn, i.e. 3.7% of GDP. The budget is based on the assumed price of Urals oil of USD 50 per barrel, a 3% decrease in GDP and a dollar-rouble rate of 61.5.

In the past year, over RUB 12 bn (USD 300 million at the then-prevailing exchange rate) of the National Welfare Fund's assets have been used to cover pension expenditures in the federal budget. In the past year, RUB 600 bn (USD 10 bn) was invested in various economic support measures. These support measures have not reduced the reported total value of the Fund, but they are reflected in changes in the allocation of the Fund's investments. The recorded changes in the value of the Fund are mostly due to exchange rate movements, as possible other changes in the value of investments are not continuously reassessed. The government has decided to use in 2015 a maximum of RUB 550 bn (USD 9 bn) of the National Welfare Fund to finance measures in support of economic growth. In January–March, over RUB 200 bn was drawn from the Fund to finance e.g. various infrastructure projects. Infrastructure projects have been financed by purchasing securities issued by companies executing the projects and by making deposits in the VTB bank, which transfers the assets to government-approved projects.

Table 4 National Welfare Fund's deposits at VEB, 1 April 2015, bn RUB and bn USD

Use of deposits	Rouble-denominated deposits bn RUB	Dollar-denominated deposits bn USD	Repayment of deposits (at latest)
Loans to Russian credit institutions	75		2019/2020
Acquisition of Gazprombank shares	50		2016
Loans to SMEs	30		2027
Loans to the Agency for Housing Mortgage Lending	40		2020
Recapitalisation of VEB		6	2029
Not specified		0.3	2019
Total	195	6.3	

Source: Russian Ministry of Finance.

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