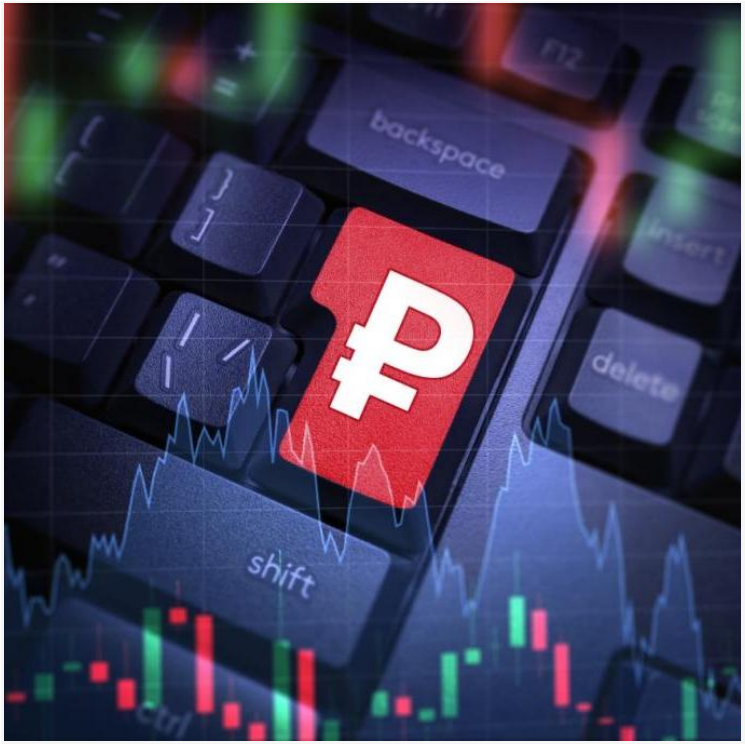


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Strong Rouble Going Against Its Historic Karma

It has been a long time since the situation with the Russian currency exchange rate was as controversial and at the same time as explicable as it is today.

The decision of the Central Bank to raise the key rate from 16% to 18% has not had any effect on the situation: the rouble shrugged it off at the OTC trades, holding its ground near □85+. Will it be weakening over the next few months? The answer to this will most likely be negative – primarily for foreign trade reasons: import volumes are sliding due to major issues with cross-border settlements.

Over the latest weeks the rouble has mostly been getting stronger – versus the yuan, the dollar and the euro. Back on June 20 the rate of the American currency for some time plunged to the almost

forgotten value of □80, which was indirectly caused by the US sanctions against the Moscow Exchange (June 12), which ended the exchange trading in the American and the European currencies in Russia.

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These events are largely reminiscent of the picture of the summer of 2022, when the dollar could be bought for □55, and people at the Ministry of Finance of the RF clutched their heads trying to figure out how they would replenish the state budget.

As for the present day, a certain role could have been played by a tax payment period (peaking on Monday, July 29), when exporters convert their foreign currency revenues into roubles to make tax payments to the state budget, increasing the demand for roubles and consequently their value.

The same series of classic explanations includes the traditional effect of raising the key rate, which, by the way, is a purely monetary and regulatory measure: loans become more expensive, correspondingly, the price of the money supply, circulating in the economy, is growing. Plus, despite the vacation season, there is dwindling demand for cash foreign currency from the population at the background of rising rouble deposit rates and almost complete termination of dollar and euro settlements in Russia.

Troubled Payments

In the meantime, there is a fundamental and rather severe impediment, making all the rest pale in comparison to it. In the first half of 2024 the foreign trade account surplus of the RF (the difference between exports and imports) rose up to $67,8 billion versus $56,8 billion in the first half of last year. At the same time, according to the Federal Customs Service, the exports slid by $2,8 billion, and the imports fell by $13,8 billion, due to the sanctions pressure on the economy of the RF and its partners from the West, primarily from the USA.

The product group data shows a decline of chemical industry product deliveries to the RF (minus 16,5%), and also a slump in supply of machinery, equipment and vehicles (minus 4,9%).

Previously Alexei Podshekoldin, president of the Russian Automobile Dealers Association (RADA), stated that there were growing issues with the imports of Chinese cars and spare parts. According to him, due to fears of being exposed to secondary sanctions of the USA, banks in the PRC block payments from Russian importers. And overall about 80% of yuan payments are returned to the RF. Customers have to use middleman services and account for extra fees for deals, making it a dead-end situation. The business sees a way out in using digital financial assets (DFA), but it has not gone into practice yet.

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As Maxim Osadchy, head of CFB Bank analytics department, told **BM. Moscow Foresight** in his interview, the existing model of the Russian-Chinese trade plays a key role in the strengthening of the rouble, operating as a shut-off valve: strong yuan flows come from China to Russia – predominantly for energy resource exports, and the reverse yuan river (from the RF to the PRC) is getting very shallow, the imports from China are contracting. Ultimately, this makes both the state budget and the exporters suffer from currency payment shortages. There was a similar situation in the trade with India, which actively increased its purchases of oil from Russia, paying for it with low-liquidity rupees. In turn, product supplies from India turned out to be incomparably small due to a lack of demand from Russian customers.

“For now, I do not see any trend towards a weaker rouble, - as Alexei Vedev, Director of the Center of Structural Research, RANEPA, told **BM. Moscow Foresight** correspondent. – Our trade balance is significantly skewed towards exports: we obviously sell abroad more than we buy. There is also contracting outflow of capital, because now there are higher external economic risks. I think that the monetary authorities will try to maintain a corridor of ₽85-₽90 per dollar. It is clear that the state budget and commodity exporters benefit from a weaker rouble: it ensures higher rouble profits from the same amounts of foreign currency receipts”.

New Infrastructure Risks

One month ago the Ministry of Finance made it clear that it was not happy with the current exchange rate and in July increased (for the period of up to August 5) the volume of daily purchases of foreign currency and gold up to ₽5,4 billion, i.e. by one and a half times: from ₽71,1 billion. (in June) up to ₽123,8 billion. Every time when the state resorted to this procedure in line with the fiscal rule, the domestic currency rate lost its positions versus the dollar and the euro, making it easier to fill the main “coffer” of the country – the National Wealth Fund.

“Larger foreign currency purchases are aimed at increasing demand. According to market laws, the higher the demand, the higher the price, - notes Igor Nikolayev, chief research fellow of the Economy Institute of the RAS. – The goal is clear – to weaken the rouble, possibly by market methods. After all, according to the scenario conditions for the development of the Russian economy, published back in April, the average annual dollar exchange rate in 2024 should be at ₽94,7. This value underlies the forecast, which will be used to adopt the budget for the next three years. Today the budget runs with a deficit, and just recently the State Duma has passed amendments, increasing the budget expenditures by ₽522 billion, up to ₽37,1

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trillion. Ultimately the budget deficit will rise to ₽2,12 trillion., or to 1,1% ВВП, and something needs to be done with this".

Of course, the public purse needs a different course of action, otherwise it will face unavoidable financing complications, all the more so as the expenditures of the Ministry of Finance to repay the domestic debt are growing: according to forecasts, in 2024 these expenditures will amount to 1,3% of the GDP (₽2,4 trillion), in 2025 — 1,5% of the GDP (₽2,9 trillion), in 2026 – 1,7% of the GDP (₽3,4 trillion), says Nikita Maslennikov, lead expert of the Political Technologies Center. According to him, the situation remains unpredictable: the suspension of exchange dollar and euro trades in July further unnerved the business community and gave rise to new infrastructure risks. Essentially, now we are seeing the whole exchange rate discovery system being rebuilt, and this process involves emotions and expenditures. The over-the-counter market, which now hosts trades in the American and European currencies, still lacks proper currency conversion mechanisms, these will take some time to develop.

"Trade participants cannot fully assess currency risks and get rid of the "permitted" currency, the yuan: exporters are selling it in a hurry, having no idea of any further architecture of cross-border interbank payments, - believes Maslennikov. – The yuan supply exceeds the demand, and this imbalance is increasing, an excess of the currency leads to sliding exchange quotes, and the rouble remains strong".

When the Moscow Exchange was put on the American SDN List, threats grew stronger, especially for Chinese banks, which risk secondary sanctions against them for servicing Russian customers. For the Russian business this means higher costs, larger fees: today at least three-four transactions are required instead of just one (previously), accounts have to be opened with five or six Chinese banks, and not with one or two. And sometimes money just sits at correspondent accounts for 30–40 days and then gets wired back. Settlements in the trade of Russia with friendly countries will be getting more expensive and taking more time.

However, Maslennikov thinks that the existing situation could altogether accelerate development of a new settlement system under the BRICS Bridge – multilateral currency clearing, based on the turnover of digital financial unions. For now, it is at the level of expert developments and talks between finance ministers of the BRICS member countries.

Counterproductive Measure

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On July 12, exactly one month after the introduction of a new package of American sanctions, the RF government eased its requirements for mandatory repatriation and sale of foreign currency revenues. Previously major exporters credited to their bank accounts no less than 60% of foreign currencies, received under foreign trade contracts. Now the threshold has been lowered to 40%, and it could potentially be canceled for good in the near term. The measure, introduced by a Presidential Decree in October 2023 (at that time the threshold was at 80%) and initially aimed at stabilizing the Russian financial market, has become counterproductive. Moreover, it became so due to the US sanctions against the Moscow Exchange, which ultimately turned foreign banks away from Russian payments for imports. This resulted in accelerated foreign currency "overstocking" (primarily with the yuan), the supply broke away from the demand, and the trend for a stronger rouble became even more obvious.

As a matter of fact, the Bank of Russia never veiled its skepticism about the government requirements for exporters from the start: as Elvira Nabilullina, head of the regulator, said in October 2023, the measure "would not have a significant effect" on the exchange rate, which "is generated under the impact of fundamental factors - exports, imports, attractiveness of the national currency as store of value".

Analysts concur: over the historic long-term outlook the rouble will be gradually and inevitably getting cheaper: that's its innate peculiarity, "karma" of a developing country currency. But any such currency has long periods of stone-still exchange rate within a given range. This is exactly what we are seeing today: a strong external economic factor (increased positive trade balance due to issues with cross-border payments) outweighs any other factors, including even oil prices, and obviously not contributing to a weaker rouble rate.

Georgy Stepanov.

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