FX intervention and FX reserves management

Central Bank of the Russian Federation

Abstract

Russia introduced its inflation targeting regime in 2015. Subsequently, fiscal policy was changed with a view to reducing the economy's dependence on natural resource prices; these changes are known as "the fiscal rule". At the same time, a financial stability policy and its instruments were developed. These changes in the monetary, fiscal and financial stability policies are the main factors that have influenced FX reserves accumulation and adequacy, intervention policy and reserves management in recent years.

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1. Monetary policy

Following the adoption of an inflation targeting regime, the inflation target has been set at a CPI rate of 4% and central bank monetary operations now focus on short-term rouble interest rates. The rouble exchange rate is free-floating. Hence there is effectively no FX intervention policy within the monetary policy rules.. Monetary policy operations as a result do not lead to the significant accumulation of FX reserves and do not require large amount of FX reserves to be available at any moment.

2. Fiscal rule

The fiscal rule aims to limit the extent to which the regular budget expenditure depends on volatile tax revenues from natural resources. While natural resource prices are high, the extra budget surplus is saved in the form of foreign currency-denominated assets. Once natural resource prices fall below predefined levels, the budget may include some of the previously accumulated savings.

Russian taxes are almost entirely paid in domestic currency, as are budget expenditures. The fiscal rule requires that, while natural resource prices are high, the Federal Treasury uses surplus revenue to purchase foreign currency and sells it once prices fall. This approach allows flows of foreign currency sold by taxpayers to be matched with the Federal Treasury's purchases of foreign currency while natural resource prices are high. When these prices fall, the Federal Treasury becomes the seller of the previously accumulated foreign currency.

These FX purchase and sale operations are carried out not by the central bank but by the Federal Treasury. The value of FX operations under the fiscal rule is restricted, being limited to either the rouble amount of accumulated extra tax revenues or the amount of the foreign currency purchased earlier.

These restrictions mean that these FX operations under the fiscal rule cannot be considered as setting or managing the rouble exchange rate policy. The rouble exchange rate continues to be free-floating, and the Federal Treasury is a large FX market participant that cannot and does not aim at a particular rouble exchange rate.

All purchases and sales of foreign currency are sterilised via the central bank's monetary policy operations. The Central Bank of the Russian Federation administers the FX purchase and sale operations under the fiscal rule and may stop them if it determines that they are a threat to the financial stability. The foreign currency accumulated by the Federal Treasury's purchases under the fiscal rule has the effect of increasing Russia's FX reserves. However, sales of this foreign currency are limited by the overall amount and schedule of budget spending. From an FX reserves management perspective, any spending (portfolio outflow) of foreign currency under the fiscal rule is relatively predictable in terms of amounts flowing out during the next few months.

3. Financial stability

This relatively new type of financial policy has two sets of implications for financial stability: (i) issues that are commonly experienced worldwide; and (ii) country-specific issues. The commonly experienced financial stability issues arose mainly during and after the 2007–09 global financial crisis. Among these, free-floating exchange rates proved to be a generally better shock-absorbing policy than FX intervention-based policy. The trivial conclusion is that, during the crisis, more FX reserves were better than less. Further, excess debt creation in an economy should be more closely monitored and addressed in good time etc.

The country-specific financial stability implications for Russia arise mostly from the industrial structure of the economy, its emerging market economy characteristics, and the sanctions regime that restricts the access of Russian corporations and government to the global capital market.

Russia's financial stability policy assumes the possibility of FX intervention, including outright sale of foreign currency and foreign currency lending (FX swaps, FX repo and FX lending). Outright foreign currency sales are decided on an ad hoc basis; the timing and amounts are not precisely predictable, and any intervention would require sterilisation via monetary policy operations.

The central bank provides FX lending through overnight swaps available daily on standby terms. Other types of FX lending (repo and loans) may be quickly activated if needed. But the unpredictability as to the timing and amount of any intervention creates a challenge for FX reserves management and, as a result, a strong FX liquidity preference is applied when the FX reserves asset allocation is decided.

4. FX reserves management

The above-mentioned foreign currency transactions, within the frameworks of the fiscal rule, as well as the financial stability and monetary policies, define the investment objectives and constraints for the central bank's FX reserves management. Asset allocation decisions (on currencies, asset classes etc) reflect to the extent possible the estimated amounts, currencies and timing of potential reserves usage.

The effects of changes in the monetary, fiscal and financial stability policies on FX reserves accumulation and adequacy, policy and management are summarised in the table below.

Monetary, Fiscal, Financial Stability Policies and FX Reserves

Table 1

	FX reserves accumulation and adequacy	FX intervention policy	FX reserves management
Monetary policy (introduction of inflation targeting)	Less important for monetary policy	Not required for monetary policy	Monetary policy demands less from FX reserves management
Fiscal policy (introduction of the fiscal rule)	Performed according to the fiscal rule	Performed according to the fiscal rule	The fiscal rule is relatively predictable for FX reserves management
Financial stability (common and country-specific circumstances)	More important for financial stability	Required for financial stability, mostly on ad hoc basis	For FX reserves management, financial stability is less predictable