

6 June 2019

Periodical

OFZ performance



Source: MICEX, VTB Capital Research

FX and Rates Comment

6 June 2019

Market Update

RUB: giving up gains in the evening. Wednesday was a relatively calm day in terms of newsflow. Major equity markets continued edging upward on the back of dovish comments from Fed Chair Jerome Powell and Vice Chair Richard Clarida: the Nikkei 225 Index grew 1.8%, the DAX inched up 0.1% and the S&P 500 rose 0.8%. In FX, DXY Index climbed 0.2% DoD amid solid non-manufacturing PMI data. EM currencies mostly eased 0.1-0.4% vs. USD. ZAR underperformed, softening 1.5% on local drivers. The UST curve steepened further, with the 2Y yield down 3bp and 10Y closing flat. RUB eased 0.4% to 65.34/USD, slightly underperforming EM peers. During the day, it touched 64.96, which we believe was propelled by the international bid in OFZs auctions. However, later it pared gains, with Brent closing 2.2% in the red (WTI -3.4%) after the release of US crude inventory and production data (both were markedly up). Meantime, we highlight that the majority of tenors in USDRUB implied volatilities decreased 8-15bp yesterday despite a weaker RUB. Currently, 3M, 6M and 1Y tenors are less than 1pp away from their lows since the transition to a freely floating RUB in 2014 (vs. 4-5pp higher in the beginning of 2019).

Yesterday, MinFin announced that it would conduct FX purchases in the amount of RUB 310bn (excluding the catch-up component) over the period from 7 June to 4 July. In daily terms, this corresponds to a RUB 16.3bn purchase. This is a slight decrease from the RUB 16.7bn daily in 14 May-6 June period.

Today's main focus for the financial markets is the ECB policy announcement and the ECB's press conference. The markets expect no change in the ECB's refinancing rate, extended 'forward guidance' i.e. any rate hike deferred well into the future as well as a re-launch of the ECB's TRTRO programme (an 'all-you-can-eat' bank funding vehicle).

Money market: mixed dynamics. Overnight rates started the new averaging period on a mixed footing. The overnight interbank rate rebounded, rising by 11bp to 7.65% in weighted average terms yesterday. At the same time, weighted average overnight FX swap stayed unchanged at 7.86% on Wednesday, but we highlight that the session was rather volatile yesterday. In the morning, the overnight FX swap started to gradually move northward, crossing the 8% mark in the middle of the day. However, the bid for liquidity visibly subsided in the evening, with the rate falling to 7.19% by the close.

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Perhaps, the system enjoyed some budget spending flows yesterday, but overall we believe that the budget factor was likely negative for liquidity on Wednesday. Banks reduced their debt to Treasury by RUB 408bn yesterday, majorly due to the unwinding of the overnight repo operations. Another RUB 67bn of liquidity should have been sterilized through the primary OFZ auctions yesterday. We believe that the volume of correspondent accounts will be around RUB 2.1-2.2tn as of this morning, which is rather low level for the beginning of new averaging period, in our view.

Rates in other segments continued to narrow, driven by the recovery of risk sentiment on the Russian market and continuous easing of monetary policy expectations for this year. FRAs tightened another 3-5bp yesterday, with the 9x12 tenor being outperformer (down 10bp to 7.45%). The IRS curve bull flattened a bit, as shorter rates nudged 3-5bp downward and longer tenors slipping 6-8bp. The long end of XCCY curve shifted down by 10bp, while other segments narrowed 5-8bp. We highlight that the curve has become less inverted recently, with the 2s5s spread rising to -28bp from its April levels of -40bp.

Local debt: global bond rally in action; trading ideas update. EM local debt markets wrapped up yesterday's session in the black, with 10-year benchmarks tightening 3-7bp in yield (and only a few exceptions). OFZs did not stay on the sidelines of the rally, extending its weekly gains. Solid results at MinFin's auctions (see below) fuelled stronger sentiment. The bullet curve moved lower and flattened: the long segment tightened 5-7bp in yield, the middle decreased 2-5bp and shorter issues lowered 1-3bp. RFLB 28 (YTM 7.74%) was the top-performer across the entire curve, having decreased 9bp in yield DoD. MOEX volume was RUB 46.5bn. RFLB 24 7.4 (YTM 7.63%) was the most active issue, recording RUB 8.6bn turnover.

MinFin placed a total of RUB 67.5bn of two bullet issues at its weekly auctions yesterday. With a total demand of RUB 167bn, the bid-to-cover ratio was equal to 2.5x, in line with the auctions the previous two weeks. At the RFLB 24 7.4 auction, MinFin allocated RUB 47.5bn, setting a cut-off yield at 7.64% with no price concession. Demand for it was RUB 112.5bn. The share of non-competitive bids in the allocation was high, at 81% this time (in line with the non-competitive share at the previous RFLB 24 7.4 auction in May). Four bids accounted for 50% of the entire placement, while there were 38 bids satisfied in total. At the new RFLB 25 auction, MinFin allocated the entire offered RUB 20bn with a 7.74% yield cut-off. This was equivalent to a 6bp yield premium to the outstanding bullet issues, on our estimates. Demand totalled RUB 54.7bn. The share of non-competitive bids was 9%. The largest accepted bid made up near 50% of the entire placed amount.

Separately, we highlight that our idea to buy RFLB 26 7.95 and RFLB 34, weighted in a 0.6/0.4 proportion, is close to its target level after this week's rally. Such a combination of OFZs is currently yielding 7.87%, which is just 7bp above our 7.80% target. RFLB 29 (which is equal in duration to the aforementioned combination) converged to 7.80% in yield, yesterday. In our view, the long-end of the curve might see strong resistance at this level without further dovish hints from the CBR and/or improvement of global risk-sentiment. We recommend taking profits here.

Our quantitative OFZ yield curve model puts the fair 10Y OFZ yield at 7.90% for the current set of fundamentals. Meantime, RFLB 26 7.95 is also just a few basis points from our target. The bond tightened 30bp in yield since we launched the idea. At the same time, we still expect to see a flatter curve and thus keep our RFLB 29/RFLB 20 flattener open. The reason is that we expect MinFin to soon launch new-format RUONIA-floaters, which would likely help unwind the current squeeze at the short-end of the curve. Now the spread between them is exactly at our target of 40bp (vs. 63bp at the idea's opening in April). We revise it to 20bp for the horizon of six months.

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