

OFZ Weekly

What do you trust more, bonds or FX?

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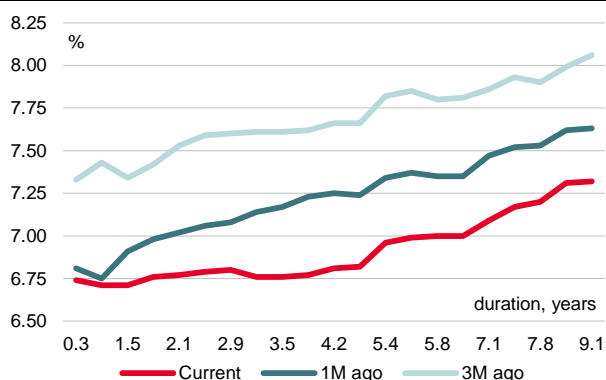
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Market thoughts

This year, just as many times before, August proved a very special month for Russian sovereign local bonds – but for a particular reason. Bonds rallied while the ruble suffered a painful battering. Actually, this was also the case for many other Emerging Markets, as seen in the chart below. So, which is right, the rosy bond segment or the gloomy FX space?

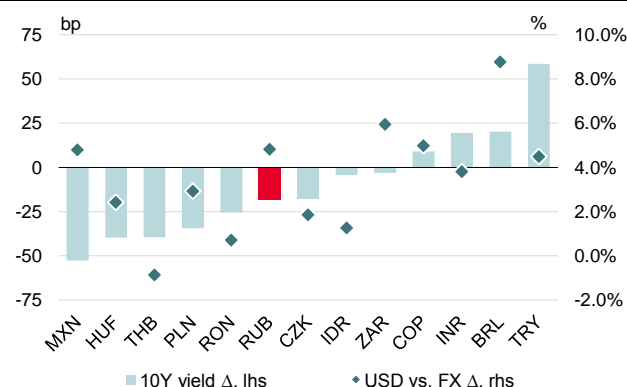
As our faithful readers will know, we are generally bullish on Russian bonds most of the time, if for no better reason than it's extremely tough to pick the right moment to short them. However, yesterday we threw in the towel, closing our long-dated call to buy the RFLB 7.95 10/26 benchmark (see the [Trade Idea Monitor](#)), as we see the balance of risks in the short term as skewed more towards a market correction than a continuation of the rally.

OFZ curve dynamics



Source: Bloomberg, SG Cross Asset Research/EM

EM asset performance in August



Source: Bloomberg, SG Cross Asset Research/EM

The key words here are ‘the short term’ – we continue to see Russia’s case as strong fundamentally. We are still talking about a country with impeccable fiscal metrics (sovereign debt < 15% GDP, a twin surplus of the federal budget and the current account), with domestic inflation structurally contained by the weakness of domestic demand (likely to dip below the 4% target in early 2020) and with the Central Bank poised to continue gradual policy easing. And, there are strong technical reasons for the recent market move, with the primary offer in fixed-rate OFZ benchmarks out to end-2019 estimated by us potentially as low as RUB140bn (see our latest [OFZ Auction Deep Dive](#)).

That said, over the next 4 to 8 weeks, there are just too many adverse risk factors that could lead to profit-taking in OFZs. These risks include the following:

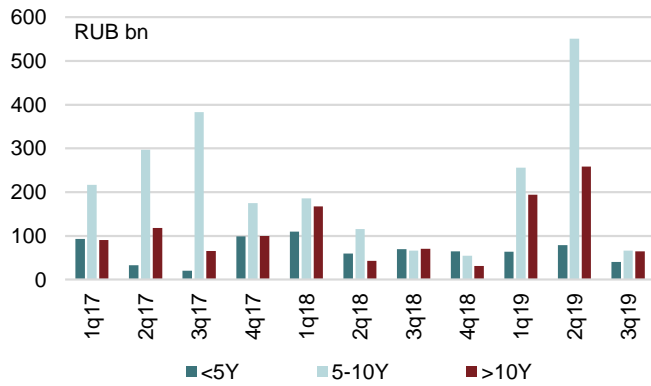
- **Jitters on the global markets**, stemming from investors having priced in more central bank dovishness than the regulators are ready to deliver (see [one of the latest write-ups](#) from the SG Rates strategists), or the US-China trading spat intensifying, or Boris Johnson pushing too hard for a no-deal Brexit, or the political woes of continental Europe re-surfacing, etc.
- **Geopolitics**, which is always a wild card for Russia.

- **Excessive hopes for CBR softness.** With most market participants expecting the CBR to cut the key rate by 25bp on Friday, the focus has been slowly shifting to when the next rate cut after that will be. In our view, even if the CBR were to cut the rate again in 2019 (in October or December), it won't be ready to indicate this in this week's press-release, for several reasons:
 - The CBR is likely to wait for more clarity on the Finance Ministry's proposal to invest part of the National Wealth Fund in domestic projects (i.e. a relative loosening of fiscal discipline).
 - The Central Bank would see reaching the upper bound of the neutral range (6-7%) as an important watermark and would probably want to observe how inflation behaves around the 4% target before elaborating a clear strategy of further moves.
 - It is likely the CBR would want to see greater appetite for ruble assets over a longer period of time, which would maintain the stability of the Russian financial market (even if the bank would never confirm this openly in the press release).
 - General caution, in view of the shaky global markets.

As mentioned previously, these concerns aren't detrimental to the Russian case – they just make us think the recent rally has gone too far, too fast. We will be looking for the right moment to reinstate a long positioning in Russian Govies, but at a more reasonable price level.

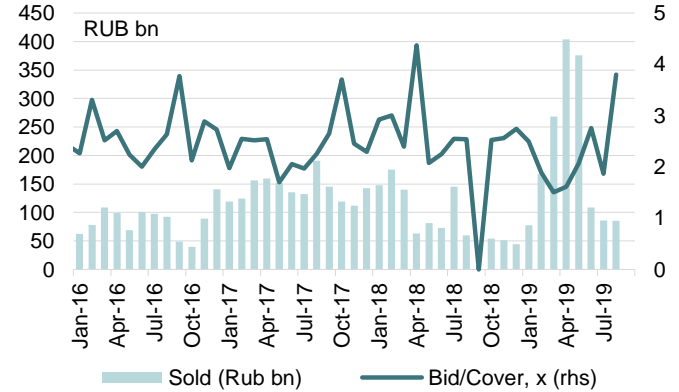
Market snapshot

Primary supply breakdown



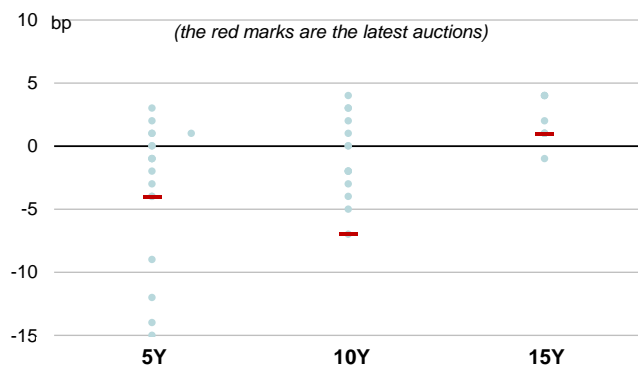
Source: MinFin, SG Cross Asset Research/EM

Primary auction results



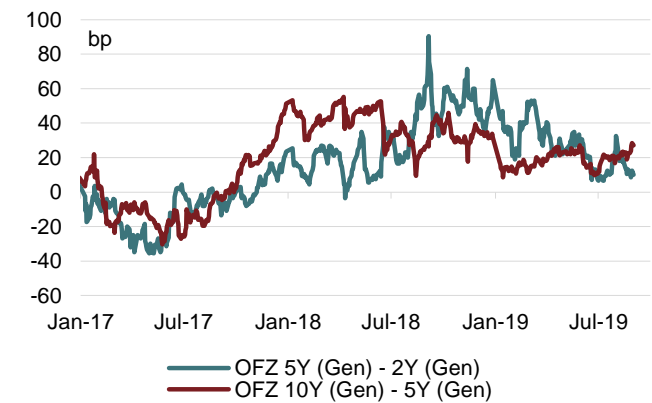
Source: MinFin, SG Cross Asset Research/EM

Primary auction yield premium in 2018-19



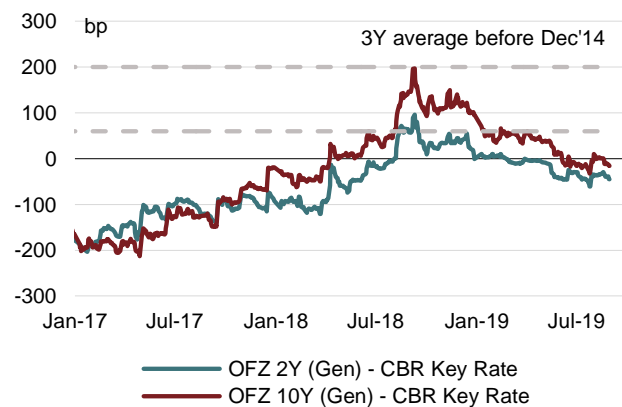
Source: MinFin, Bloomberg, SG Cross Asset Research/EM

OFZ spreads evolution



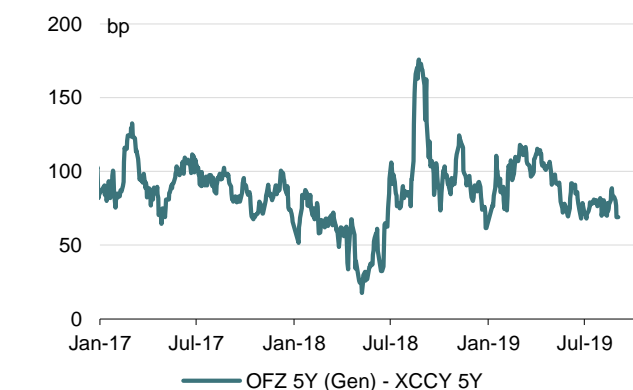
Source: Bloomberg, SG Cross Asset Research/EM

OFZ positioning vs key rate



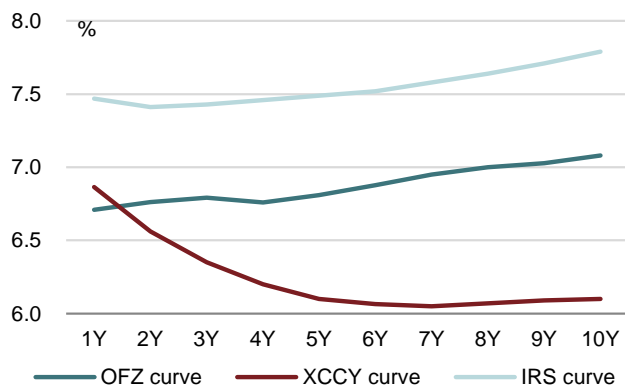
Source: CBR, Bloomberg, SG Cross Asset Research/EM

OFZs vs XCCY curve



Source: Bloomberg, SG Cross Asset Research/EM

Key RUB curves



Source: Bloomberg, SG Cross Asset Research/EM

Russia 4Y breakeven inflation dynamics



Source: Bloomberg, SG Cross Asset Research/EM

Selected bond mathematics

Paper	Duration, yrs	Price	YTM, %	1M carry, bp*	ASSW, bp
OFZ 26210	0.25	100.03	6.74	-13	-104
OFZ 26214	0.67	99.84	6.71	-6	-85
OFZ 26205	1.41	101.49	6.71	-6	-73
OFZ 26217	1.73	101.54	6.76	-6	-63
OFZ 25083	1.99	100.69	6.77	-6	-63
OFZ 26209	2.45	102.37	6.79	-6	-64
OFZ 26220	2.73	102.05	6.80	-6	-63
OFZ 26211	2.87	101.05	6.76	-5	-67
OFZ 26215	3.29	101.19	6.76	-6	-68
OFZ 26223	3.71	99.38	6.77	-6	-67
OFZ 26227	3.89	102.89	6.81	-6	-67
OFZ 26222	4.01	101.66	6.82	-6	-65
OFZ 26229	4.71	101.85	6.89	-5	-64
OFZ 26219	5.07	104.97	6.96	-5	-61
OFZ 26226	5.10	105.98	6.99	-9	-59
OFZ 26207	5.38	107.27	7.00	-4	-60
OFZ 26212	6.02	101.04	7.00	-4	-63
OFZ 26224	6.64	99.51	7.09	-4	-65
OFZ 26228	6.84	104.48	7.17	-5	-52
OFZ 26218	7.24	111.40	7.20	-3	-31
OFZ 26221	7.93	104.42	7.31	-3	1
OFZ 26225	8.49	100.48	7.32	-1	15
OFZ 26230	9.73	105.13	7.34	-1	66

Source: Bloomberg, SG Cross Asset Research * carry is calculated based on the assumption of funding at Mosprime 1M

Key parameters of RUONIA-linked floaters

Paper	Amt. outstanding, RUB bn	Maturity	Coupon rule	Current cpn, %	Price	Next Refix date	Average RUONIA since last refix
OFZ 24019	108	16.10.2019	RUONIA +30bp	7.75	100.16	16.10.2019	7.38
OFZ 29011	250	29.01.2020	RUONIA +97bp	8.52	100.70	29.01.2020	7.09
OFZ 24020	10	27.07.2022	RUONIA	-	100.30	30.10.2019	7.10
OFZ 29012	212	16.11.2022	RUONIA +40bp	7.94	101.38	20.11.2019	7.32
OFZ 29006	390	29.01.2025	RUONIA +120bp	8.73	105.48	05.02.2020	7.07

Source: MinFin, Bloomberg, SG Cross Asset Research

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