

# Financial Stability Review

**Q2-Q3 2022**

1 December 2022

## Background

Russia's economy and financial system are gradually adjusting to the sanctions.

The Bank of Russia regards it as a priority to maintain financial stability, the confidence of investors and depositors in the Russian financial system. The central objectives are to mitigate currency risks by gradually decreasing the use of 'toxic' currencies; to strategically reorient Russian infrastructure towards the markets of friendly countries; to timely phase out the regulatory easing; and to start building up buffers.

In addition, the regulator will continue to consider in its policy the impact of global risks through the current account channel and will focus on the situation in the emerging market economies (EMEs) given Russia's reorientation towards their markets and use of their currencies in settlements.

Like the previous issue of the review, the current one covers the primary transmission channels of the sanctions' shock to the Russian financial sector. It also presents an integral stability assessment of the banking sector and non-bank financial institutions.

### 1. Currency channel

In Q2-Q3 2022, the trend towards an accelerated dedollarisation of the Russian banking sector continued. Concerns regarding the escalation of sanctions risks and management of open currency positions by some banks caused a temporary liquidity shortage of unfriendly currencies in early October 2022. This situation did not have a noticeable effect on either the spot foreign exchange market or financial stability, in general. However, it once again underscored the importance for banks to return to the balanced open currency position, especially for those who are in breach of this ratio.

Amid the structural economic transformation, the priority is to ensure a balanced transition to the currencies of friendly countries not only in exports, but also in imports, and financial account payments (where 'toxic' currencies are primarily being used so far). Given the increasing share of assets in EMEs currencies exposed to greater volatility, the banking sector should properly assess the risks associated with these assets.

## Share of friendly countries' currencies in export payments and in exchange currency market settlements (%)

Source: data from banking control statements, MOEX.

### 2. Stock market channel

Anticipation of new sanctions and a deteriorating situation at major companies pulled down Russian share prices. Against this background, the Moscow Exchange index (IMOEX) fell by 20% in late September (by 42% from the beginning of the year). Concurrently, in Q2–Q3 2022, federal government bonds (OFZ) yield curve mostly declined (on average, the yields increased by 69 bp from the beginning of the year) on the back of lower inflation expectations and the key rate cut by the Bank of Russia. The impact of losses from the materialisation of market risks on the financial position of banks and non-bank financial institutions (NFIs) has been limited.

In the absence of non-residents, private investors became key players in the Russian equity market. Yet, a lower value of Russian shares may make private investors disappointed about the Russian equity market outlook. Given these circumstances, it is important to take actions to safeguard investors, encourage investment, and solve the problem of frozen assets.

### OFZ yields (%) and IMOEX (points)

Source: MOEX.

### 3. Interest rate channel

Amid declining interest rates in Q2-Q3 2022, losses from the materialisation of interest rate risks did not significantly affect the financial performance of banks. Meanwhile, banks' reliance on short-term funding has increased noticeably since the outbreak of the crisis. To lower the interest rate risk, it would be reasonable for banks to offer their customers long-term deposits with a sizeable premium to the interest rates on short-term instruments. Additionally, in a bid to reduce the systemic interest rate risk, the Bank of Russia is examining ways to boost the development of a long-term funding market.

### Share of short-term ruble liabilities (up to 1 year, including funds in accounts) to individuals and legal entities (%)

Source: Reporting form 0409301.

### 4. Income channel

The financial strength of Russian companies accumulated during the period of the post-pandemic economic recovery, partially mitigates the economic implications of anti-Russian sanctions (including entry into force of the embargo on the supply of crude oil and petroleum products to the EU). However, the risks of lower profitability of most oil and gas, metallurgy and other export-oriented Russian

companies increase in the medium term. The restrictions imposed by unfriendly countries, including those on technology imports, coupled with a potential global economic recession will have an adverse effect on the domestic investment activity, entailing a slowdown in manufacturing output and a drop in household income. Among the industries relying on domestic demand, these are automotive, aviation, and commercial real estate sectors that have taken the biggest hit from the sanctions and the exodus of foreign businesses from Russia. The escalation of geopolitical tensions in autumn also affected the housing market. After a temporary revival of demand for housing in Q3 2022, since late September supply has been significantly exceeding demand causing a price adjustment.

## Price index on the primary and secondary housing markets in Russia (QoQ)

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Source: Rosstat.

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### 5. Credit channel ▼

Amid the sanctions crisis, a decrease in corporate obligations on foreign currency loans and external debt was offset by an increase in the domestic ruble lending. This helped avoid a credit crunch. Lending was supported by government-backed programmes and lower interest rates. Retail lending also rebounded quickly after a drop in the first months of the crisis.

To support corporate lending, the Bank of Russia is developing approaches to risk-sensitive incentive-based regulation. This will help ensure the structural adaptation of the economy. The incentives will be designed to support the financing of the priority areas with no undue risks to the financial system.

The Bank of Russia decided to introduce [macroprudential limits](#) starting on 1 January 2023 seeking to ensure a balanced development of unsecured consumer lending that will not entail individual debt burden risks. This will make the lending structure more robust without creating additional capital requirements for banks.

Also, the Bank of Russia closely monitors risks related to mortgage lending. In Q2–Q3 2022, this segment recorded deterioration of lending standards and the spread of risky practices, such as ‘developer-subsidised mortgages’. To curb such practices, it is planned to increase the rate of provisioning for mortgage loans depending on the loan effective rate. If mortgage-related risks continue to accumulate, the regulator may consider to increase macroprudential add-ons for mortgage loans with high debt service-to-income (DSTI) ratios and low down payments.

## Changes in the banking sector’s loan portfolio since 1 March 2022 (%)

### Loans to individuals

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### Loans to legal entities

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Source: Bank of Russia, reporting forms 0409101, 0409115, 0409316.

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## 6. Insurance channel

The sanctions imposed by unfriendly countries primarily affect the insurance and reinsurance of Russian risks. The readjustment of inwards insurance led to the concentration of insurance risks on Russian National Reinsurance Company (RNRC), the market share of which rose to 66% making the company much more systemically important.

Also, geopolitical risks affect the car insurance segment due to higher cost of vehicle overhaul. The expansion of a basis tariff corridor and the release of a new guide for calculating insurance payments based on the prices for substitute spare parts will help balance the OSAGO (compulsory motor third party liability insurance) system. Life insurers continue to tackle a problem with the payment of additional investment income that was mainly ensured by investments in foreign assets that are now frozen.

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## 7. Technology channel

The Russian financial sector sees a rise in technology risks amid the exit of foreign tech companies, sanctions, and ensuing problems with the imports of IT equipment. Banks and NFIs should pay special attention to the level of operational efficiency and cybersecurity, increasing resilience to technical failures. Financial institutions should make sure that this category of operational risks is duly managed, including related to outsourcing arrangements. The Bank of Russia is developing regulation of credit institutions' outsourcing relationships.

# Assessment of financial sector stability

Temporary regulatory easing curbed the impact of financial market volatility on the operation of banks and NFIs enabling them to continue lending to the economy in the crisis period. Lessons learnt from the pandemic proved that it is crucially important to timely phase out regulatory easing. In this regard, the Bank of Russia intends to cancel part of introduced easing, including those related to securities revaluation and exchange rate fixing to calculate required ratios. Regarding loans segment, it is planned to gradually phase out the easing of forming provisions, i.e. for large corporate borrowers – by 30 June 2023; for retail borrowers and SMEs – by 31 December 2023. Additionally, credit institutions will keep the right to make concessionary provisions for the blocked assets whereby the provisions for such assets can be made on a step-by-step basis over ten years.

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## 1. Banking sector

The banking sector remains strong due to an accumulated capital reserve. After sizeable losses incurred in Q2 2022 due to the materialisation of currency and interest rate risks, and making loan loss provisions, banks resumed making profit as early as in Q3 amid decreased volatility and the recovery of interest margins. After the first ten months 2022, the loss incurred by the banking sector amounted to 0.4 trillion rubles.

The results of the Bank of Russia's stress testing of the banking sector over the period until the end of 2023 show that the sector will generally remain stable even if the sanctions pressure on the Russian economy persists and borrowers' credit quality deteriorates. In case of stress, only a handful of banks may require recapitalisation: its total volume is estimated at up to 0.7 trillion rubles over the forecast horizon. Meanwhile, the need to increase capital may be spread over time or decline since banks are actively replenishing their capital.

## Banking sector's profit structure\* (₪ trillion)

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Source: reporting form 0409102.

\* For all credit institutions excluding the non-core asset bank.

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### 2. Non-bank financial institutions

NFIs' financial position remains fairly stable. The profitability of insurers and returns on pension savings and reserves have decreased but their level is acceptable. NFIs are gradually adjusting their business to the new environment. They demonstrated a recovery trend as early as in Q2 2022. Nevertheless, some unit investment funds (UIFs) and life insurers continue to struggle with the problems that emerged in Q1 2022 and are primarily related to the freezing of their foreign assets. There is a certain deterioration in the financials of aircraft leasing companies.

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To learn more 

Department responsible for publication: [Financial Stability Department](#)

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