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Financial Stability Review

Q4 2022–Q1 2023

26 May 2023

Background

The Russian economy and financial sector continue to adapt to sanctions. The Bank of Russia's priority, in any scenario, is to maintain financial stability and the confidence of depositors and investors in the Russian financial system. Mitigation of currency risks by gradually decreasing the use of 'toxic' currencies, development of correspondent banking with friendly countries, strengthening attractiveness of the Russian stock market and savings in rubles in general, limitation of citizens' debt burden risks and ensuring balanced development of mortgage lending market are among key objectives.

The Bank of Russia continues to consider in its policy the impact of global risks through the current account channel of the balance of payments, including as the result of strengthening ties with friendly countries. The recent months saw the rise in uncertainty regarding global growth prospects. The market volatility episode in spring 2023 caused by banking turmoil in the USA and Europe reflects possible hidden problems in global financial system and highlights the importance of regulation and supervision adaptation to the risks' scope and nature. Financial regulators' toolkit should include the necessary instruments to support financial stability (both during upward phase of credit cycle and in case of financial sector stress) so that materialisation of risks should not impede monetary tightening. If inflation remains high in advanced economies, coupled with stress in the financial sector, it can cause stagflation in the global economy for some time.

This issue of the review covers the main vulnerabilities of the Russian non-financial and financial sectors and presents their integral resilience assessment.

Vulnerabilities and resilience of the Russian non-financial sector

Vulnerability 1. Sanctions exposure of business

The sanctions, introduced by western jurisdictions, continue to have adverse impact on the Russian corporate sector. Companies face decreased sales revenues (amid oil embargo, restrictions on import of metallurgical products from Russia), as well as higher operating and capital costs as they need to enter new markets, replace imported equipment and as a result of higher shipment costs.

Companies of export-oriented sectors were able to redirect most of their trade flows to new markets, but have faced decreased revenues. Meanwhile, a number of domestic-oriented sectors (airlines, automotive and commercial real estate sectors) are heavily exposed to sanction pressure after the cutting off of the spare parts and components supplies for manufacturing and the exit of a number

of foreign companies from the Russian market.

Vulnerability 2. Exit of foreign investors from Russian assets

Foreign companies are exposed to political pressure in their countries which leads in some cases to the suspension of their operations and investments in Russia or sometimes even to their withdrawal from the Russian market. The impact of selling of Russian subsidiaries by foreign investors is limited within the scale of Russian economy: during the period from March 2022 to March 2023 approximately 200 deals of this kind took place, while only 20% of them were transactions involving the sale of large assets by non-residents (above100 million US dollars). The relevant transactions are reviewed by a subcommittee of the Government Commission on Monitoring Foreign Investment in the Russian Federation, and involve a significant discount to the market value and a tax paid to the budget. In some cases, a change of ownership is required to maintain the business continuity of socially important enterprises. However, such transactions can carry risks related to volatility spikes in the FX market, uncertainty regarding future perspectives of acquired businesses and higher debt burden of the acquired companies and their buyers.

Assessment of the resilience of Russian non-financial companies

At the end of 2022, most of the Russian export-oriented companies demonstrated low level of the debt burden and stable level of profitability. However, in Q1 2023, revenues of some export-oriented companies declined due to the entry into force of sanctions and volatility on the global commodity markets.

Amid the reduction in external debt, businesses have mainly been funded by raising ruble loans and issuing corporate bonds. Moreover, there is a shift from lending in ’toxic’ currencies to the loans denominated in Chinese yuan (CNY, yuan). In the medium term, the companies’ demand for higher working capital and implementation of economic transformation projects will become drivers for lending.

Vulnerabilities of the Russian financial sector

Vulnerability 1. Further restriction of access to payment infrastructure in 'toxic' currencies

The situation with settlements and correspondent banking in ’toxic’ currencies continues to deteriorate amid the expansion of sanctions. Index of correspondent relationships in ’toxic’ currencies with unfriendly countries decreased from 1 October 2022 to 1 April 2023, while the same index for the ’non-toxic’ currencies of friendly countries, on the contrary, shows the development of correspondent relationships. An increase in the share of friendly countries’ currencies in export and import transactions and FX market is observed. As the transition to the currencies of friendly countries is uneven, the domestic FX market suffers periodic imbalances, expressed in higher cost of FX liquidity. To support FX liquidity, the Bank of Russia has launched yuan FX swaps.

Net export, breakdown by currency (billion)

Source: Bank of Russia calculations.

Vulnerability 2. Offshorisation of the citizens' savings

The volume of citizens' transfers to their accounts with foreign banks and brokers increased significantly in 2022. These funds are largely used to finance foreign purchases and overseas trip expenses, but the remainder reflect an offshoring trend for the citizens' savings. In theory, portfolio diversification (including across countries and industries) means higher returns on investments, but in case of unfriendly countries, its benefits may be offset by uncontrolled sanctions risks. Moreover, the citizens carry risks related to financial resilience of foreign financial institutions. This trend for offshorisation of the citizens' savings leads to reduced liabilities base for the banking sector, and to higher borrowing costs for the economy in general.

The vulnerability associated with the offshorisation of savings is still limited (an increase by 4.1 p.p. to 19.2%[1] from 1 January 2022), and citizens continue to invest mainly in ruble deposits (42.2% of household savings), moreover, investments in Russian equities have also increased during this period. Maintaining public confidence in the stock market remains to be one of the key challenges, which depends on the prospects of Russian companies and their financial disclosures.

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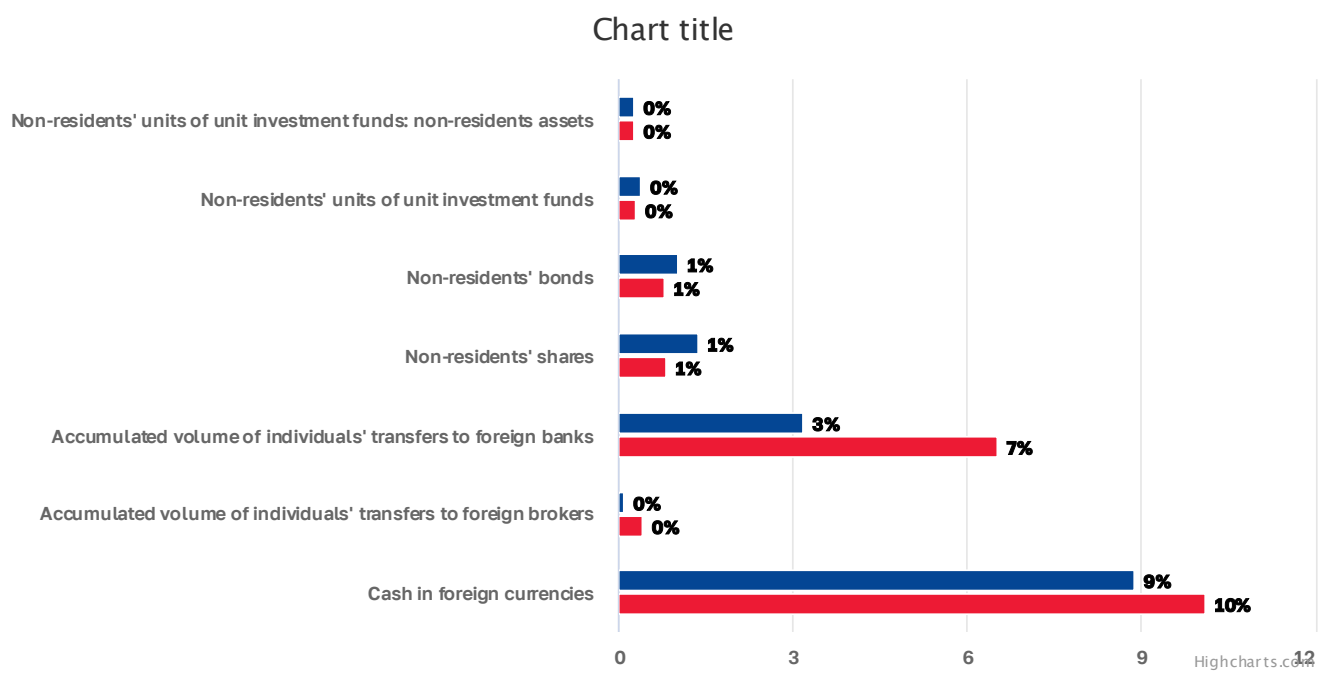
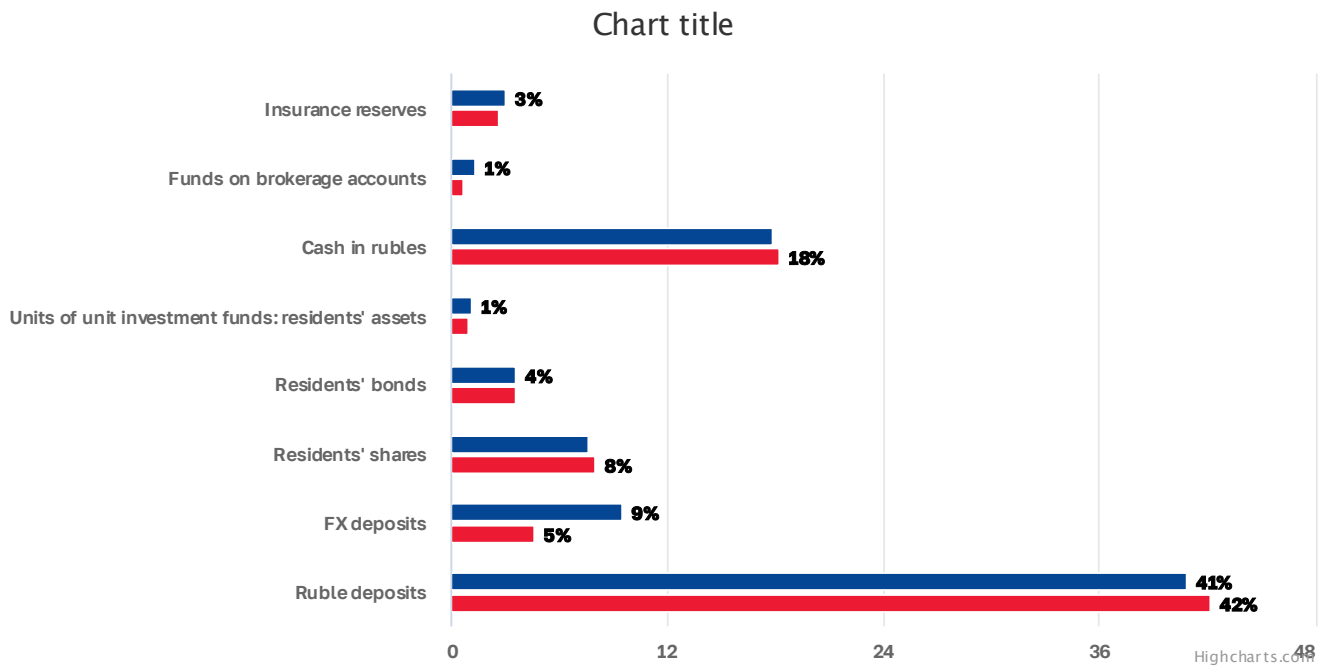
[1] This indicator is calculated as the ratio of accumulated volumes of fund transfers by individuals to foreign banks and brokers, foreign currency cash and foreign securities to the volume of deposits and brokers' funds, cash, investments in securities, funds in individual life insurance and endowment life insurance.

Total investments of individuals, breakdown by instrument (₽ billion)

Non-resident instruments ∑ 15% → ∑ 19%



Resident instruments ∑ 85% → ∑ 81%



Source: forms 0409711, 0420415, 0409405, Households savings.

Vulnerability 3. Rising household debt

Retail lending activity began to recover in H2 2022, which was accompanied by deterioration in lending standards. In order to prevent an excessive increase in the debt burden of citizens, since the beginning of 2023 macroprudential limits have been set for banks and microfinance companies on retail lending to borrowers who spend more than 80% of monthly income on debt payments, as well as limits regarding the share of long-term consumer loans (more than 5 years).

The introduction of limits has resulted in banks tightening their lending standards and thus the structure of unsecured consumer lending has improved: the share of loans with debt service-to-income ratio (DSTI) of 80%+ dropped to 29%.

To promote continued decrease of the citizens' debt burden and improvement of lending structure, limits have been reduced further for Q3.

Distribution of issued unsecured consumer loans by DSTI

Source: form 0409704.

Vulnerability 4. Imbalances in the residential real estate market and risks of project financing

By the end of Q1 2023, the price gap between the primary and secondary housing widened to 40% due to government-subsidised mortgage programs and their combination with marketing schemes implemented by banks along with developers. Such environment creates risks primarily for mortgage borrowers. If the borrower is not able to service the loan, the collateral value of housing might not be sufficient to repay mortgage debt.

To limit the risks in mortgage lending, the Bank of Russia has introduced increased provisioning for loans issued after 15 March 2023 at an effective interest rate significantly below the market

and on 1 May 2023 also established tighter macroprudential capital requirements for the low down-payment mortgage.

Declining sales in the primary housing market can negatively affect developers' financial stability. Banks are also facing risks as over the last few years they have significantly increased project financing of this segment. However, banks are continuing to increase lending to developers, including in order to ensure the timely completion of ongoing projects.

Dynamics of the price gap between the primary and secondary housing markets in Russia

Sources: Rosstat, Bank of Russia calculations.

Vulnerability 5. Interest rate risks of banks amid growing public debt

The recovery of the net interest margin supports the banking sector's resilience in case of materialisation of interest rate risk. However, the exposure of banks to interest rate risk exceeds the pre-crisis level: the share of short-term liabilities remains higher than in early 2022. In this context (and amid regulatory easing of liquidity ratios), banks limit their investments in fixed-coupon government bonds, which contributed to maintenance of high long-term yields. The latest episode of the US crisis proves that banks need to improve the balance of maturity of assets and liabilities, and use up-to-date approaches to calculating interest rate risk and liquidity risk.

Share of short-term liabilities (up to 1 year, including cash in accounts), %

Source: form 0409101.

Assessment of the financial sector resilience

Banking sector

The financial position of credit institutions is recovering. The capital reserve remains at RUB 6 trillion[1] excluding the effect of temporary support measures. The current regulatory easing, in part, contributes to favourable financial results, although a large number of the regulatory requirements has already gone back to pre-crisis standards in early 2023. In 2023, the capital reserve has also been supported by the refusal to pay dividends by many banks (in 2022 only RUB 139 billion was allocated for this purpose, almost five times lower than in 2021).

[1] The assessment is based on reporting forms 0409135, 0409123 and banks surveys as of 1 March 2023.

Non-bank financial institutions (NBFIs)

The accumulated financial cushion, coupled with the measures taken by the Bank of Russia, allowed NBFIs to withstand the impact of the materialisation of geopolitical risks, general stagnation,

and a number of major insurance events in the commercial real estate insurance segment.
At the end of the year, all segments of NBFIs (except for leasing companies) mainly reported profits, and Q1 2023 saw a recovery growth in their key performance indicators. At the same time, we note that losses from the asset freeze have not yet been fully reflected in the balance sheets of NBFIs and will be written off over several years.

To learn more

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