

Financial Stability Review

Q4 2021–Q1 2022

31 May 2022

Overview

In recent months, policy measures of the Bank of Russia were determined by the need to mitigate risks to financial stability that increased due to imposed sanctions.

These measures were aimed at supporting financial institutions, ensuring stability of payments, supplying financial institutions with necessary liquidity, preventing creditor and depositor panic, forestalling fire sales of Russian assets and mitigating other risks to financial stability.

Due to the freezing of its reserves in unfriendly jurisdictions, the Bank of Russia lost the ability to intervene on currency market, therefore ensuring financial stability required introduction of restrictions on capital movements.

The implemented measures ensured stabilisation of financial markets. This allowed gradual easing of capital account restrictions, cancellation of several forbearance measures, and reduction of the key rate.

Overall, after the surge in February–March, risks to financial stability reduced, albeit remaining elevated. Policy measures of the Bank of Russia and the Government helped reduce the risks. Accumulated buffers and strong financial positions of Russian financial institutions at the time of risks' materialisation were the important sustainability factors.

The future prospects of the Russian economy will be determined by the processes of its structural transformation. In this circumstances, the Bank of Russia is focused on supporting the sustainability of financial sector which would provide the necessary funding for the transformation of the economy.

The Bank of Russia will take into account global trends and risks, which will continue to make impact on Russia through current account despite sanctions.

The current Review identifies six transmission channels of the sanctions' shock to the Russian financial sector. It describes their impact, risks and mitigation measures.

1. Foreign currency channel ▼

The introduction of sanctions primarily caused the exit of foreign investors from the Russian financial market, which followed by the reduction of FX liquidity and growth of ruble exchange rate volatility. Implemented currency restrictions and currency control measures allowed to stabilise the situation.

As foreign currency accumulated in the domestic market due to the sales of exporters and reduction

of demand on currency from local participants, the FX liquidity situation significantly improved and the introduced currency restrictions on residents' transactions were relaxed. Further efforts of the Bank of Russia will be aimed at encouraging the reduction of dollarization of economy and financial sector. The role of the USD and the euro will be diminishing whereas the importance of currencies of friendly countries will grow together with the role of ruble in settlements on foreign trade transactions.

Russian FX market dynamics during increased volatility episodes

2. Stock market channel

Large-scale sales of Russian assets by foreign investors after the introduction of sanctions were accompanied by a drop in stock indices, increase of bond yields and larger volumes of margin calls. The suspension of exchange trading and other measures introduced by the Bank of Russia made it possible to stabilise the situation.

OFZ yields returned close to the levels prior to the shock, stock indices slowed-down their fall and financial infrastructure maintained its sustainability. The shock resulted in significant reduction of trading volumes and increase of the retail investors' role. In the near future, the stock market will be primarily affected by internal factors, and the further development of the market will be closely linked to the speed of the structural transformation of the Russian economy, development of internal financial market and building links with financial systems of friendly countries.

Russian financial market dynamics during increased volatility episodes

	Equity market		OFZ market	
	Index change	Volume of net purchases (+)/ sales (-) by non-residents and subsidiaries of foreign companies on secondary exchange trades, bln rubles	Change of 10 year OFZ yields, bp	Volume of net purchases (+)/ sales (-) by non-residents and subsidiaries of foreign companies on secondary exchange trades, bln rubles
Market reaction indicators				
6 – 12 April 2018 (US sanctions)	-3,8%	-16,9	38	-80,5
7 – 17 August 2018 (sanctions draft laws and outflows from EMEs)	-1,9%	-2,6	77	-55,9

20 – 28 February 2020 (coronavirus)	-10,6%	-29,6	48	-27,5
2 – 19 March 2020 (coronavirus and oil shock)	-18,3%	-100,1	170	-132,1
13 – 25 January 2022 (security negotiations)	-14,9%	-107,5	108	-78,4
21 – 25 February 2022 (non-residents exit)	-27,2%	-139,9	277	-78,2
21 March – 22 April 2022 (crisis response measures)	-11,5%	-6,5	-261	9,1

3. Interest rate channel ▼

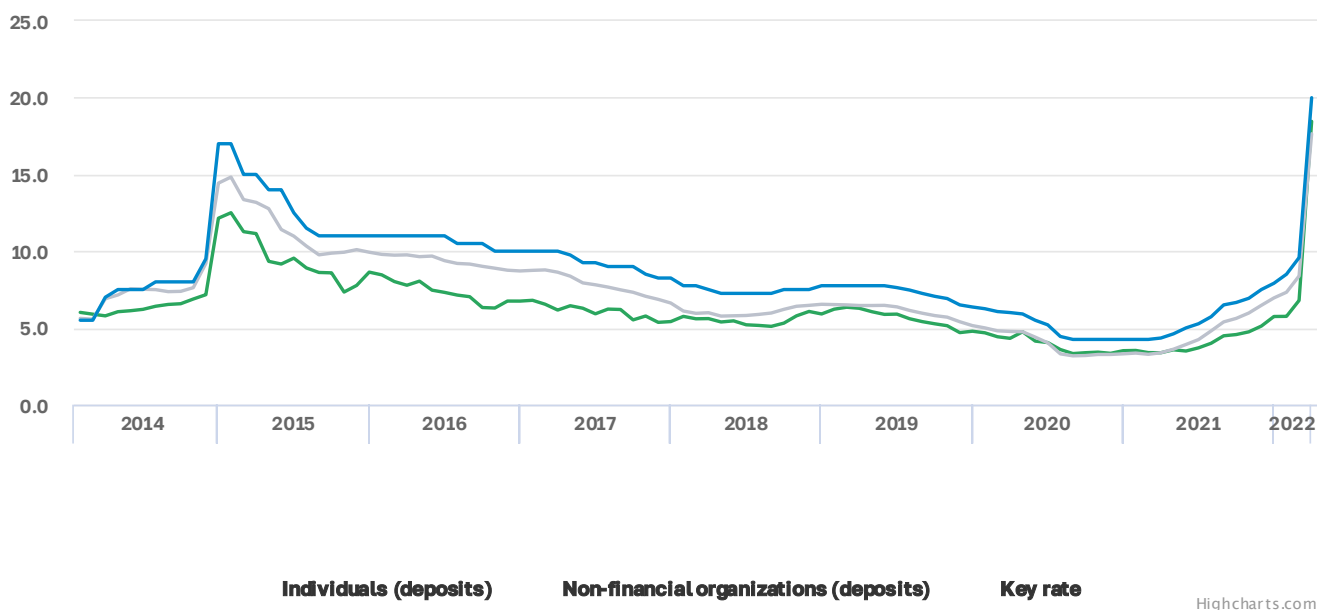
The exit of non-residents from the Russian market and increased uncertainty caused higher volatility and increase in yields on the Russian market even before introduction of sanctions. The banking sector faced massive deposit withdrawal in the late February and early March (in both Russian rubles and foreign currencies). In this context, the Bank of Russia temporarily raised key rate to 20%. The increased key rate made it possible to reduce risks to financial stability, ease inflationary pressure, ensure the safety of households' savings and stabilise the liquidity situation in the banking sector.

However, at the same time, this resulted in the increased interest expenses for companies with floating-rate liabilities and in the materialisation of interest rate risk for banks and leasing companies that faced greater than expected growth of expenses on borrowed funds. Increased rates and the exit of non-residents affected the liquidity of the interest rate derivatives market, which limited Russian companies' options in hedging. The subsequent key rate cut helped significantly reduce the financial sector's expected loss from interest rate risk. Restructuring programs have also partly offset interest rate risks of the borrowers. The estimate of the interest rate risk of the banking sector in rubles over a one-year horizon lies between ₧0.3 to 0.7 trillion¹, which is equivalent to 8-17% of the banking sector's net interest income for 2021.

¹ Interest rate risk estimate over a horizon of up to 1 year in accordance with the structure of assets and liabilities as of the time of the rate shock (data from reporting form 0409127 as of 1 January 2022), taking into account the hike in the Bank of Russia key rate from 9.5% to 20% and subsequent rate cuts in the banking sector during the year. The estimate varies depending on assumptions about the changes of maturities of attracted funds due to interest rate shock.

Dynamics of deposit market rates, %

Chart title



4. Income channel

The sanctions introduced against Russian real sector, in particular restricted access to Western financial and commodity markets, logistic chains disruption and prohibition of the supply of some goods in Russia led to a downturn in economic activity. Companies in the air transportation industry, export-oriented companies, the automotive industry, the commercial real estate sector and construction industry were affected the most. However, the generally moderate debt burden of many non-financial companies, which became lower in 2021 amid post-COVID recovery, contributes to their resilience.

Aggregate debt burden in oil and gas, metallurgy and mining, fertilisers industries for 2020-2021

5. Credit channel

Shift in the macroeconomic conditions amid introduction of sanctions have had a deterrent effect on lending to the real economy in March-April 2022. In the corporate lending, foreign currency debt have decreased significantly, but this reduction has been partially offset by the demand on ruble loans. In retail lending, a downturn in lending activity was observed, primarily in the segment of unsecured consumer lending, while mortgage lending has been supported by state concessional lending programmes.

To support lending the Government of the Russian Federation and the Bank of Russia have modified existing and launched new concessional lending programmes (mortgage, lending to SMEs, systemically important companies) and introduced regulatory support measures (release of macroprudential capital buffer in the amount of ₺0.9 trillion, reduction of add-ons to risk weights on new loans, easing of provisioning requirements on restructured loans). In the contexts of crisis caused by sanctions credit

risk have increased significantly, but it is difficult to assess possible losses at the beginning of structural transformation of the economy. The share of loans restructured by banks amounts to about 6% of the corporate loan portfolio, which is largely caused by the restructuring of floating-rate loans according to the law. In the retail lending segment, 0.6% of debt have been restructured, however the demand for loan restructuring may increase in the second part of the year due to increased unemployment.

Share of restructured debt, %

6. Insurance channel ▼

Limitations on international reinsurance in case of occurrence of large insurance event could affect financial standing of Russian insurance companies and their problems could spill over to their policyholders. In response, Russian insurance market is decreasing dependence on reinsurance companies from unfriendly countries and will switch to internal extended reinsurance capacities.

Amid higher prices on car parts and interruptions in their supply OSAGO insurers could face a certain increase in the loss ratios. However, no significant problems are expected in the segment – the insurance market has a sufficient capital buffer: the ratio of own funds to liabilities as of the end of March was 1.64, and the value of the total amount of own funds was ₪465 billion.

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