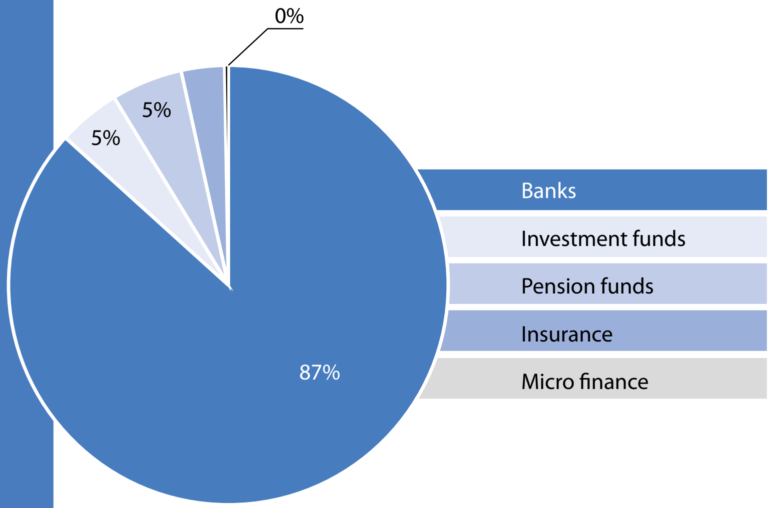
Overview of the financial sector in Russia

Commercial banks play a major role in the financial sector of Russia as is the case in other BSTDB member countries. However, the role of the bond market in Russia is relatively stronger compared to other member countries and it has been increasing in the last 10 years. The banking system in Russia, which harbors 366 banks that include 248 banks with a universal license and 118 banks with a basic license, reported total assets of RUB 103.8 trillion ($1.4 trillion), as of 31 December 2020 (99% of GDP). The banking sector accounts for around 87% of the total assets in the financial sector. Other financial institutions such as investment funds, pension funds, Insurance, and microfinance institutions are rather small.

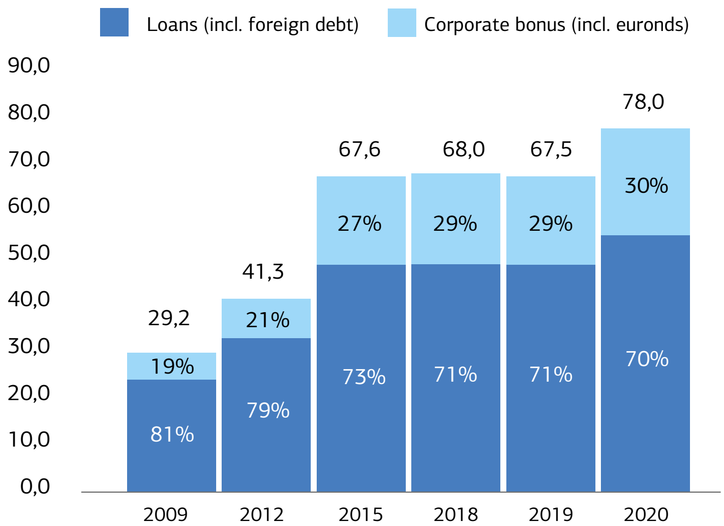
Figure 1. **Structure of the financial sector of Russia as of the end December 2020**



Source: Bank of Russia

Together with the banking system the securities market has become a significant source of raising funds for the corporate sector over the last decade. As of the end of 2020 around 30% of corporate borrowing is done in the bond market.

Figure 2. **Corporate loans vs corporate bonds in Russia, RUB tn**



Source: Bank of Russia, Russian Financial Sector Investor Presentation, March 2021

Financial penetration in Russia is high with the banks' total assets at around 100% of GDP. The banking sector in Russia is highly concentrated with the two largest banks holding around 50% of the market. Systemically important financial institutions (12 banks) account for 75% of the total assets of the Russian banking sector. The two largest banks Sberbank and VTB Group are both state owned. Together with other state owned banks, the share of state owned banks in the banking sector is 72%. Domestically owned private banks account for 18% of the total banking sector assets, while foreign ownership in the banking sector is rather small at 10%.

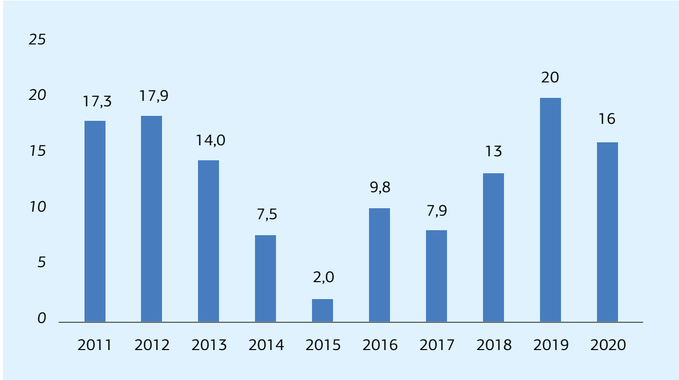
Banks in Russia are well capitalized as the capital adequacy ratio has been above the required minimum for the last decade. The capital adequacy regulation is based on Basel III principles. The total capital requirement is 10.5% of the risk weighted assets out of which 2.5% is a capital conservation buffer. In addition, systemically important banks are required to keep 1% additional buffer. In response to the Covid19 crisis Bank of Russia encouraged banks to use the capital conservation buffer and the buffer for systematically important banks to cover potential losses. Despite this relaxation, the capital adequacy ratio is maintained at 12% by the end of 2020.

Figure 3. **Regulatory capital to risk-weighted assets (%)**

Source: Financial soundness indicators, IMF database

The banking sector in Russia maintains sound profitability. After the drop in 2014-2015, profitability has recovered and Return on Equity (ROE) reached 20% in 2019. ROE ratio averaged at around 13% for the last 5 years, which is similar to peer countries with similar risk characteristics. In response to the Covid19 crises Bank of Russia provided banks with a regulatory forbearance that allows them to postpone the provisioning for potential losses. Taking this into account in 2020 ROE still stands at a relatively high level of 16% but the full impact of the pandemic shock is not yet reflected in numbers.

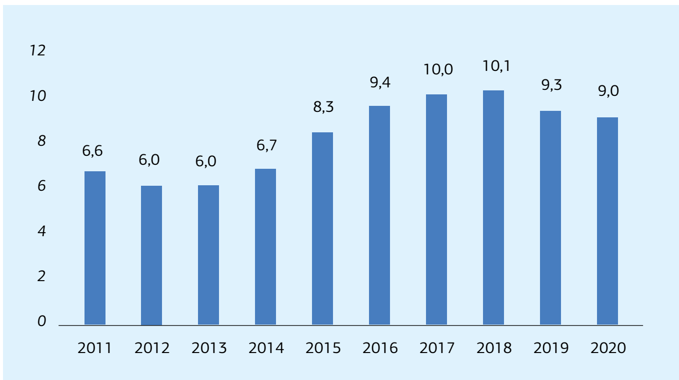
Figure 4. **Return on Equity (%)**



Source: Financial soundness indicators, IMF database

One of the main challenges of the banking sector in Russia is a relatively high level of NPLs. Non-performing loans have increased after the crises of 2014-2015 and reached 10% of the total loans in 2018. Since then it declined somewhat but still stays elevated at 9% by the end of 2020. The performance of the mortgage portfolio looks better as the share of NPLs for mortgages stays low at 1.3% and, besides, it is fully provisioned with the loan loss reserves. In contrast, NPLs in unsecured consumer lending and corporate lending are relatively high at 9% and 13% respectively. But it should be mentioned that corporate loans are fully provisioned and the provisioning for consumer lending is at 93%. As in other countries, the current level of NPLs may not reflect the real picture accurately due to the credit payment holidays and the regulatory forbearance on the classification of restructured loans that has been enacted by the authorities, which makes it difficult to assess the exact volume of NPLs in the system.

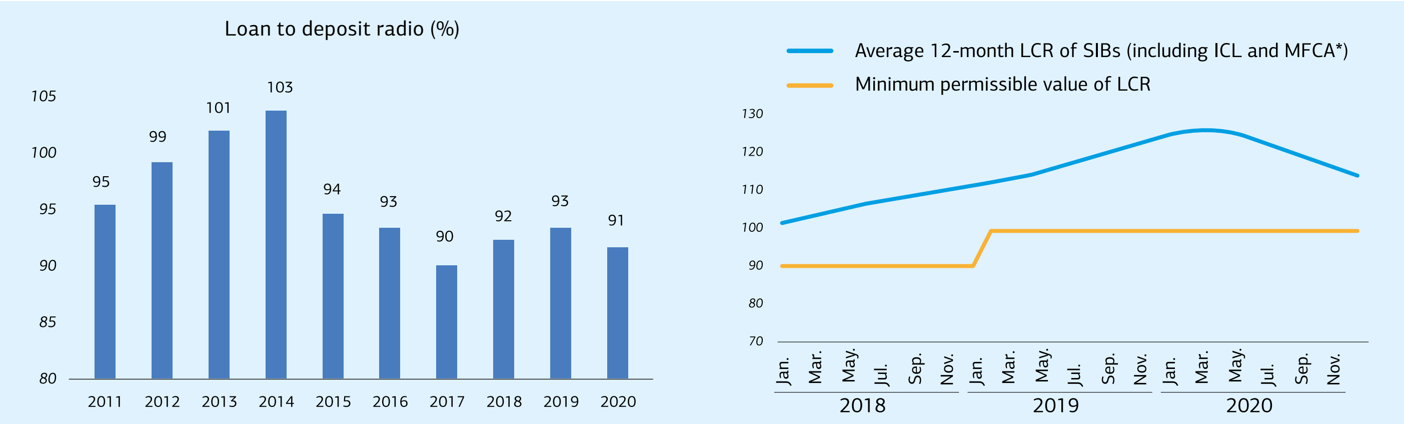
Figure 5. **Non-performing Loans to Total Gross Loans (%)**



Source: Financial soundness indicators, IMF database

Loans constitute around 62% of the total assets of the banking sector, while another 30% of the total assets are kept in liquid assets. Lending is entirely funded by deposits. The loan to deposit ratio stands at 91% as of the end of 2020. The share of deposits in funding has increased significantly in the past 6 years. After the US and EU sanctions that restrict access to international capital markets the large state-owned banks had to rely more on domestic funding. As a result, the loan to deposit ratio has decreased since 2014. Retail deposits accounted for around half of total deposits with the other half coming from corporate funds. With the volume of deposits above that of loans, the banking sector enjoys solid liquidity buffers. Liquidity Covergae Ratio (LCR) is significantly above the required minimum for the last 3 years.

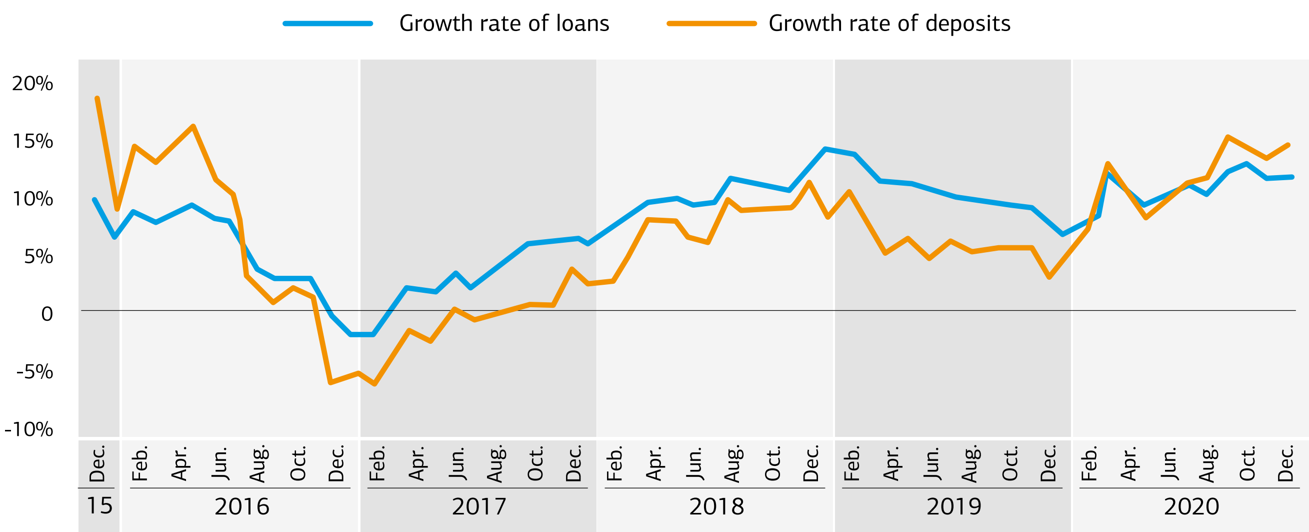
Figure 6. **Loan to deposit ratio and banking system liquidity**



Source: Bank of Russia, Monetary Survey, Financial Stability Review, 2020 Q2-Q3

Loan growth was quite strong for the last 5 years averaging approximately 8%. In 2020 it accelerated even more and reached 12% by the end of the year. The growth comes from both retail and corporate loans. Particularly strong growth was reported in the mortgage portfolio that grew by 21% in 2020. Deposit growth was also strong with an average annual growth of 6% for the period of 2016-2020. Last year deposits grew by 14% mostly driven by corporate sector funds. The growth of retail deposits, however, has slowed down last year and reached 7% by the end of the year.

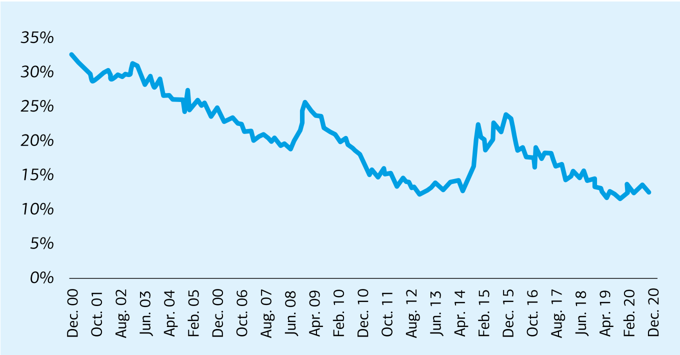
Figure 7. **Annual growth rate of loans and deposits**



Source: Bank of Russia

Overall, Russia was successful in de-dollarizing its economy and its financial sector in particular. Dollarization in Russia was declining since the early 2000s. While dollarization picked up after the crises of 2008-2009 and 2014-2015, it resumed a downward trend once the crises were over. Overall loan dollarization is quite low compared to other dollarized economies in the wider region and the BSTDB Region.

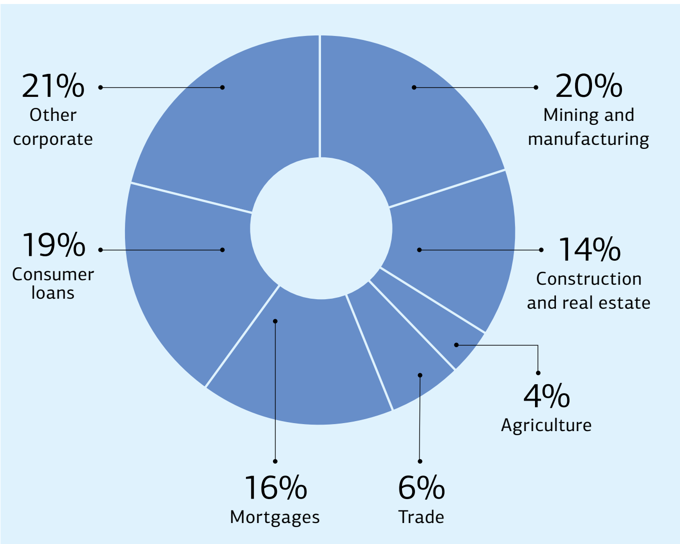
Figure 8. **Loan dollarization 2000-2020**



Source: Bank of Russia

Banks have larger exposure to corporate borrowers with a 65% share of loans to the corporate sector in the total credit portfolio. The manufacturing sector with 17% accounts for the largest share in the corporate loan book. Construction and real estate activities account also for solid part of the total portfolio. Consumer loans account for 19% of the total loans. The share of Mortgages is also important with 16%.

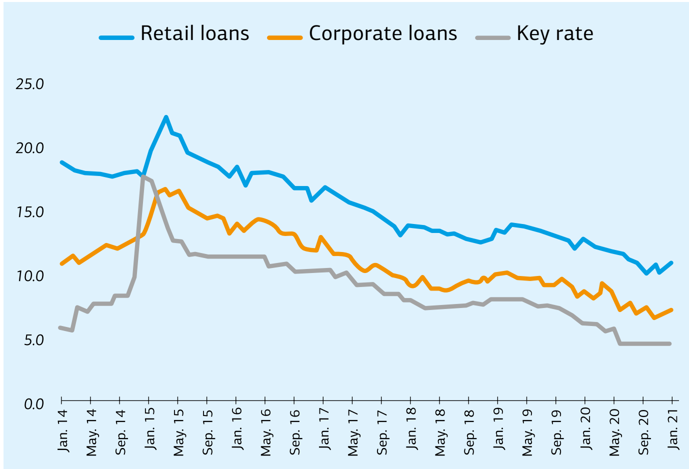
Figure 9. **Structure of the credit portfolio as of end 2020**



Source: Bank of Russia

Interest rates have been declining for the last 5-6 years. In 2014, to address potential inflationary spillover stemming from exchange rate depreciation, Bank of Russia had increased the key rate massively from 8% to 17%. As a result, lending interest rates followed and increased to above 20% per year for retail loans and above 15% per year for corporate loans. Following the FX market stabilization, BoR started cutting the key rate, and that trend continued in 2020. However, Interest rates are expected to increase as BoR started tightening monetary policy in March 2021 due to rising inflationary pressures.

Figure 10. **Key policy rate and interest rates on loans (%)**



Source: Bank of Russia

Overall the banking sector in Russia is adequately capitalized with strong capital and liquidity buffers. The banking sector is highly concentrated with state owned banks dominating the market. For the last several years, banks exhibited solid performance in terms of profitability. However, the effect of the pandemic crisis response is still yet to be seen. Overall, despite few spikes during crisis periods, Russia was successful in terms of de-dollarization of the financial system. The developing bond market offers a competitive funding venue for corporate borrowers to raise funds in the domestic market. The biggest challenge for the banking sector remains a relatively high level of NPLs that are to a high extent provisioned by the loan loss reserves but potentially may increase further as the full impact of economic slow down is reflected on the asset quality.