Bank of Russia

Q4 2023 – Q1 2024

FINANCIAL STABILITY REVIEW

Information and analytical review

Moscow
2024

CONTENS

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SUMMARY

1. Global risks

Growth forecasts for many economies have been improving amid slowing inflation, the implementation of support measures, and expectations that major central banks will start cutting their policy rates in the near future. However, the situation remains uncertain because of the risk that elevated inflation might turn out to be more persistent. According to the International Monetary Fund (IMF), global GDP growth in 2024 will remain at the level of 2023 (3.2%) amid still high policy rates. A potential acceleration of inflation might be fuelled by high energy commodity and food prices amid geopolitical risks, stronger fragmentation, rising government expenditures, and other factors. The uncertainty is also associated with differences in the dynamics of economic indicators across countries (e.g., Europe is still facing a decline in business activity in the manufacturing sector).

High borrowing costs in global markets cause partial realisation of financial stability risks. The scale of consequences might potentially increase, given the accumulated vulnerabilities (specifically, considerable debt burden). Major economies are facing a growing number of bankruptcies in the non-financial sector amid elevated interest rates and the termination of support measures introduced during the pandemic. Commercial real estate markets have been adversely affected by tight monetary policy. One more US bank – New York Community Bancorp (NYCB) – was on the brink of bankruptcy at the beginning of 2024 due to worsening quality of loans in commercial real estate. Potential stress in commercial real estate markets might cause widespread consequences for banks and other financial intermediaries. Moreover, fiscal and debt risks have been rising (especially in advanced economies). As assessed by the IMF, the global public debt-to-GDP ratio was 93.2% in 2023, which is significantly higher than before the pandemic (84.2% in 2019). The need to implement new support programmes and persistent high policy rates might increase the probability of sovereign debt crises that are sometimes accompanied by negative feedback effects for the real economy.

In the conditions of sanctions and foreign exchange measures enacted in response, not capital flows, but rather foreign trade flows remain the key channel of influence of global risks on Russia (a contraction in the current account if problems in the global financial system entail a reduction in prices and demand for oil and other Russian exports).

2. Vulnerabilities and resilience of the Russian non-financial sector

Intensifying sanction pressure on Russia and friendly countries

Unfriendly states continue to impose new restrictions on the key industries and individual entities of the Russian economy, seeking to limit Russian exports, including of energy commodities, precious metals and stones, to foreign markets.

The new restrictions enacted by unfriendly countries in Q4 2023 and Q1 2024 were targeting not only Russian companies but also businesses from friendly states. These restrictions might decrease exports and imports and make logistics and cross-border payments more complicated. Russian companies continue to search for solutions to minimise the adverse consequences of the sanctions and are actively expanding transactions in the eastward direction.

Assessment of Russian non-financial companies' resilience

Despite the growing sanction pressure from Western countries, most companies in the Russian largest industries have either improved their financial performance or maintained it at the previous year's level as a result of rebounding sales and lower debts. However, some largest borrowers have been experiencing an increase in debt burden. Overall, the corporate sector has become less sensitive to the tightening of the Bank of Russia's monetary policy: the absolute majority of borrowers have sufficient operating earnings to pay interest expense on their loans.

3. Vulnerabilities of the Russian financial sector

Changes in the composition of vulnerabilities in the Russian financial sector

As a result of the sanctions imposed by the USA on PJSC SPB Exchange during the period under review, risks of blocking foreign securities owned by Russian investors have materialised, in addition to the previously imposed restrictions of depositories from unfriendly states and as a result of the EU sanctions against the National Settlement Depository (NSD). In relation to frozen foreign securities registered in NSD, the executive order of the Russian President was enacted[1] that allowed Russian private investors to sell these securities in the amount of up to RUB 100 thousand,[2] while the Government of the Russian Federation and the Bank of Russia took action to provide mechanism to enable these operations. Therefore, the vulnerability related to citizens' investment in foreign financial instruments has largely materialised for investment in securities. In relation to cross-border transfers this vulnerability became less significant: the transfers of individuals' funds to accounts with foreign banks stabilised amid attractive ruble interest rates and the existing threat of sanctions against Russians abroad. The proportion of individuals' savings in foreign financial instruments, adjusted for foreign currency revaluation, edged down by 0.6 pp to 18.5% over the past six months. The inflow of funds into foreign financial instruments accounted for 12.5% over the period under review and 8.4% over 2023 in general, which is considerably less than in 2022 (35.2%). Hence, the review no longer highlights the problem of investment in foreign instruments as a key vulnerability.

Meanwhile, as the largest companies had been actively repaying their foreign debts, the amount of their funding from the Russian financial sector notably increased. Therefore, this review addresses credit concentration risk as a vulnerability that requires prudential measures and syndicated lending development to ensure adequate financing to the economy, while preventing excessive risks to certain banks and non-bank financial institutions.

Structural imbalances in the domestic FX market

The stable current account surplus and sustained tight monetary policy helped stabilise the ruble exchange rate against foreign currencies in Q4 2023–Q1 2024 despite the escalation of geopolitical tensions.

The trend towards a decline in correspondent relationships with non-resident banks in 'toxic' currencies continued. However, the expansion of correspondent relationships in 'non-toxic' currencies slowed down amid the threat of secondary sanctions that might be imposed by unfriendly states.

The reduction in the Chinese yuan (CNY, yuan) balances in Russian banks' interbank accounts in late 2023 was accompanied by a surge in corporate lending in yuan. As a result of the contraction of available balances in interbank accounts, the FX swap market was facing difficulties with yuan

[1] Executive Order of the President of the Russian Federation No. 844, dated 8 November 2023.

[2] For details, refer to the exchange's website.

liquidity on certain days. Such episodes were short-term and the cost of foreign currency borrowings quickly normalised, which is the evidence that there is no systemic risks in the FX swap market. Nevertheless, the Bank of Russia made the decision to expand its limit on the overnight FX swap from CNY 10 billion to CNY 20 billion during the days of the peak demand for yuan (the last and the first two business trading days of each month).

At the same time, the cost of yuan borrowings under FX swaps was raised by 100 bp in order to mitigate the impact of the Bank of Russia's transactions on market pricing.

Mainland China's banks cannot perform the functions of yuan liquidity providers because of the foreign exchange restrictions in China and risks of secondary sanctions. Thus, Russian companies' and individuals' domestic savings might be the main source of funding of Russian banks' yuan-denominated assets. Overall, given the current geopolitical environment, the share of foreign currency in the Russian banking sector will most likely be shrinking.

Growth of households' debt burden

Although the Bank of Russia tightened monetary and macroprudential policies, banks were actively expanding the portfolio of unsecured consumer loans: its annual growth rate reached 17% as of 1 April 2024. Individuals' debt burden at the macrolevel was stable amid quickly rising incomes (households spend approximately 11% of disposable incomes on loan repayments), but some households' debt burden increased nonetheless.[3]

In order to limit households' debt burden, the Bank of Russia started to apply macroprudential limits (MPLs) from 1 January 2023. The MPLs helped reduce the proportion of new unsecured consumer loans issued to individuals with debt service-to-income ratios (DSTI) above 50% from 63% in Q4 2022 to 34% in Q1 2024. However, amid rising interest rates and the suspension of the limit on the effective interest rate (EIR), banks started to issue more loans to borrowers with increased risk levels (at an EIR above 25%), which worsened the early indicators of credit quality of cash loans. With regard to credit cards that were driving the expansion of the consumer loan portfolio in Q1 2024, the quality of vintages did not deteriorate. A substantial share of disbursements was associated with more active utilisation of the limits[4] on earlier issued credit cards by borrowers. Besides, credit risk on credit cards is traditionally higher compared to cash loans. Furthermore, over Q4 2023–Q1 2024, car lending soared by over 50% in annualised terms, which was accompanied by a decrease in the lending standards: the proportion of car loans issued to borrowers with DSTI above 50% rose from 45% in Q4 2022 to 61% in Q1 2024.

Given the accelerating expansion of consumer lending and the worsening quality of loan servicing, the Bank of Russia raised the macroprudential add-ons (and set add-ons for car loans for the first time) for banks to have sufficient capital buffer in case of growth in consumer loan losses.

Imbalances in the residential real estate market and project finance risks

After the key rate hike and the tightening of the terms of government subsidised programmes, the expansion of mortgage lending significantly decelerated in Q1 2024. At the same time, from the beginning of 2024, the subsidised mortgage programmes have accounted for nearly 70% of the growth rate of mortgage lending. In such conditions, there is still a significant gap between prices in the primary and secondary housing markets. According to Rosstat, as of 1 April 2024, the gap between the average prices in the primary and secondary housing markets in Russia reached 55% (vs 9% in early 2020). As reported by Domclick, the gap equalled 45% (vs 43% in Q4 2023).

[3] As of the beginning of 2024, 13 million people had three or more loans; these borrowers accounted for half of overall outstanding debt on retail loans. For details, refer to the Bank of Russia's report (in Russian only).

[4] According to credit history bureaus' consolidated data, the utilisation (the debt-to-credit limit ratio) of the credit card portfolio increased from 32% as of 1 July 2023 to 38% as of 1 March 2024.

The tightening of the macroprudential measures in mortgage lending by the Bank of Russia and of the requirements under the subsidised programmes in the primary market by the Government of the Russian Federation encouraged banks to shift towards more conservative standards in mortgage lending. The proportion of loans issued to borrowers with DSTI above 80% decreased from 45% in Q4 2023 to 34% in Q1 2024. The share of loans with a low down payment (less than 20%) declined from 52% in Q4 2022 to 17% in Q1 2024, including in the primary housing market – from 69% to 2%.

The termination of the large-scale subsidised mortgage lending programme from 1 July 2024 and the modification of the terms of other subsidised programmes might cause a temporary reduction in the demand for housing. According to the Bank of Russia's estimates, this will not have a significant negative effect on developers as most housing construction projects are sufficiently resilient to a decline in sales revenues and extension of the period of sales. However, this will make the subsidised programmes more targeted, gradually decrease the imbalances between primary and secondary housing markets, and help maintain the affordability of housing for people.

Corporate lending and concentration risk

In the conditions of tight monetary policy, there was no significant rise in restructuring of loans at floating interest rates. Over the past six months, corporate loans were mostly restructured for reasons, other than a decline in borrowers' creditworthiness. Interest rates on part of loans (8% and 15% of the corporate and SME loan portfolios, respectively) are subsidised by the government according to the relevant support programmes. As a result, such loans are not sensitive to key rate increases. Overall, non-performing corporate loans accounted for 4% as of 1 April 2024, while banks' loan loss provisions are sufficient and amount to 74%.

As companies were actively repaying foreign debts amid the sanctions, banks significantly expanded lending to the Russian largest companies. This increased the concentration risk that had been originally high due to the historical structure of the Russian economy. The share of the Russian five largest companies' liabilities to Russian banks reached 56% of the banking sector's capital. The concentration on other companies rose as well, including because banks were financing transactions for non-residents' withdrawals from Russian assets. The Bank of Russia plans to enhance the approaches to limiting the concentration of credit risks as part of banking regulation. Furthermore, creditors are advised to develop syndicated lending to finance major projects.

Banks' interest rate risk

Although money market rates had been notably rising since July 2023, the materialisation of interest rate risk did not have a significant effect on the banking sector's resilience in late 2023–early 2024. The interest rate risk of the bond portfolio (a reduction in bond prices amid growing interest rates) was limited because of a high proportion of variable coupon bonds and bonds held to maturity. As a result, the negative revaluation of the bond portfolio in October 2023–March 2024 equalled less than 1% of the banking sector's capital. Accumulated, but not recognised negative revaluation of bond portfolio carried at amortised cost is estimated at RUB 0.5 trillion as of 1 April 2024, which is also considered to be moderate (0.4 pp of banks' capital adequacy (N1.0). Banks' net interest margin edged down in Q1 2024 from 4.8% to 4.5% due to a surge in funding costs.

At the same time, in Q1 2024 yields on 10-year federal government bonds (OFZ) increased to the peaks recorded during the 2022 crisis, driven by the expansion of borrowings by the Russian Ministry of Finance and persistent inflationary pressures. Important conditions for stable bond market are maintaining fiscal sustainability and returning inflation back to the target level, which will be ensured by the Bank of Russia monetary policy.

4. Assessment of the financial sector's resilience

Assessment of the banking sector's resilience

As a result of increased profits, banks' capital adequacy remained almost the same over the period under review, equalling 12.1% as of 1 April 2024. Banks' capitalisation increase from profits was primarily used to expand lending. Furthermore, owing to the macroprudential add-ons in consumer and mortgage lending, banks' capital buffer accumulated as of 1 April 2024 reached RUB 725 billion. Returns on assets edged down from 2.6% to 2.1% by 1 April 2024, but the decline was mainly attributed to the negative foreign currency revaluation in Q4 2023 amid the strengthening of the ruble. The ratio of the 'economic' open currency position to capital remained moderate at about 4%, which is the evidence of banks' resilience to foreign exchange risk.

Assessment of non-bank financial institutions' resilience

As of the end of Q4 2023, the annual performance of non-bank financial institutions (NBFIs) was adjusted downwards due to higher interest rates, a stronger ruble, and a number of major insured events. Nevertheless, NBFIs still demonstrated high financial resilience in 2023 and earned record profits, while returns on invested pension resources exceeded the inflation rate.

Leasing companies (with assets worth nearly RUB 6.7 trillion) are facing a decrease in capital adequacy ratios amid considerable growth in new business. The credit risks of the leasing portfolio remain elevated, which is associated with its concentration on the industries hit by the sanctions.

MAIN VULNERABILITIES

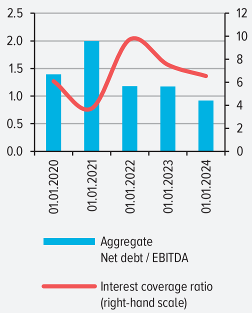
Vulnerabilities

Stability factors and measures

Intensifying sanction pressure on non-financial companies

Expanding sanctions and pressure on friendly states causes a reduction in companies' export earnings.

Largest companies' debt burden



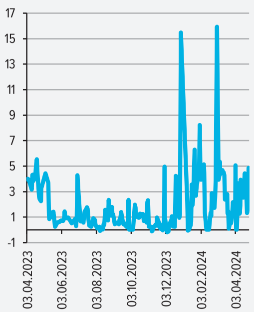
The corporate sector's debt burden is moderate overall. Most large companies either improved their financial position in 2023 or maintained it at the same level.

Structural imbalances in the FX market

Sanctions are complicating Russian banks' correspondent relationships with foreign banks, including those from friendly states.

During certain periods, the Russian market is facing a deficit of yuan liquidity.

Implied interest rate on CNY/RUB FX swaps



Exporters sell the largest part of their foreign currency earnings in the market.

The Bank of Russia expanded the limit on the CNY/RUB FX swap to CNY 20 billion during the days of the peak demand for yuan.

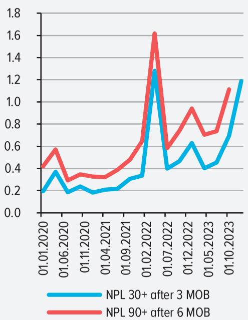
Households' debt burden

The proportion of loans issued to individuals with excessive debt burden (DSTI 80%+) exceeds 30% of the portfolio.

Individuals having three or more loans account for 50% of the portfolio (vs 40% in early 2022).

Overdue debt on cash loans issued in Q4 2023 has been growing.

Credit quality of issued cash loans, %



Banks have been accumulating the macroprudential capital buffer: as of 1 April 2024, it covered 4% of the unsecured loan portfolio and 1.2% of the mortgage loan portfolio.

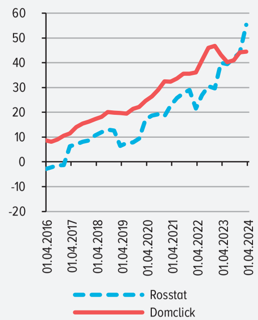
The MPLs for unsecured loans help to reduce the issuance of new loans to individuals with high DSTI: in Q1 2024, borrowers with DSTI 80+ accounted for 13% of disbursements.

Imbalances in the housing market and project finance risks

The price gap between primary and secondary housing markets remains significant due to large-scale subsidised mortgage programmes.

The mortgage and project finance markets are sensitive to tight monetary policy.

Gap between housing prices, %



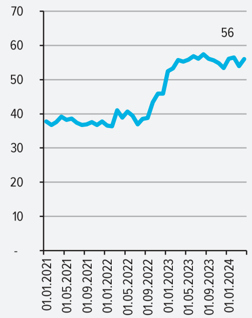
The ratio of debt coverage in construction with funds on escrow accounts is high.

Developers earned substantial profits in 2023.

Higher concentration in corporate lending

Banks' and NBFIs' exposure to the Russian largest companies has been increasing as the latter need to substitute their external debt due to the sanctions.

Ratio of the five largest companies' overall debt to banks' capital, %



Measures to limit the concentration (phasing-out of the easing related to risk weights, tightening of the requirements for identifying a group of related borrowers to calculate the concentration ratio, and introduction of concentration ratios for central counterparties).

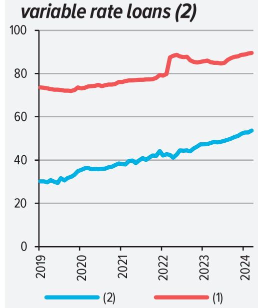
Development of syndicated lending.

Banks' interest rate risk

Risk materialisation: a decline in NIM and negative revaluation of bonds on banks' trading book amid tight monetary policy and rising OFZ yields since the beginning of 2024.

The proportion of banks' short-term liabilities has been steadily high.

Share of liabilities for up to one year to individuals and legal entities (1) and corporate variable rate loans (2)



Banks' NIM is high – 4.5%.

Companies' willingness to raise variable rate loans and a high percentage of variable coupon bonds in banks' portfolios.

Historically small public debt and conservative fiscal policy in Russia.

1. Global risks

The world economy is generally more stable than six months ago. Many countries are recording a deceleration of inflation. The risk of a global recession has decreased. However, the growth rate of global GDP in 2024 is expected to stay at the level of 2023 because of elevated policy rates maintained by major central banks and a slower expansion of global trade and investment. Persistently high inflation, potential financial stress amid elevated interest rates, further fragmentation of trade, and escalation of geopolitical risks might become destabilising factors.

Given the sanctions and the restrictions on the financial account, the key channel of the influence of global risks on Russia is still foreign trade flows: a decline in demand and/or prices for exports, as well as risks of sanctions, including secondary sanctions against friendly countries.

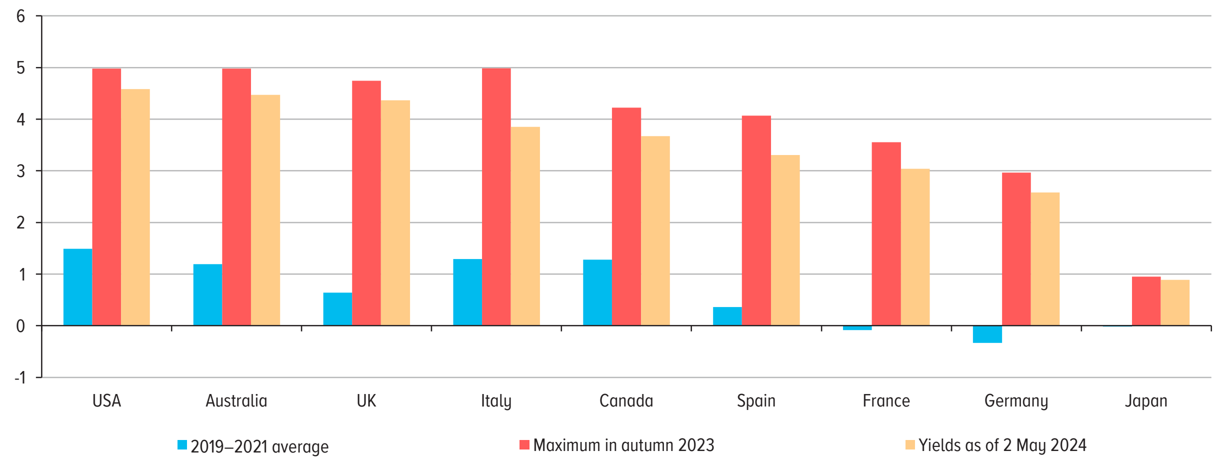
According to the IMF's estimate as of April 2024, global GDP growth in 2024 will remain at the level of 2023, equalling 3.2% vs 3.5% in 2022 (Table 1). This is associated with the continuing effect of tight monetary policies and the phasing-out of fiscal stimulus measures after the pandemic. Nevertheless, the estimate of global growth in 2024 is 0.3 pp higher than in October 2023. The IMF has upgraded its forecast of economic growth in 2024 for the USA and a number of large EMEs, e.g. China, as a result of the support measures implemented by these countries. Contrastingly, the European economy is still facing challenges. A decline in business investment is affecting the dynamics of the PMI indices that suggest a persistent decrease in production activity in the leading European countries (the euro area's overall index equalled 45.7 points in April 2024).

GDP GROWTH, IMF FORECAST *Table 1*
(%)

	2022	2023	Forecast as of April 2024		Difference vs forecast as of October 2023 (pp)	
			2024	2025	2024	2025
Global GDP growth	**3.5**	**3.2**	**3.2**	**3.2**	**0.3**	**0**
Advanced economies	***2.6***	***1.6***	***1.7***	***1.8***	***0.3***	***0***
USA	1.9	2.5	2.7	1.9	1.2	0.1
UK	4.3	0.1	0.5	1.5	-0.1	-0.5
Euro area	3.4	0.4	0.8	1.5	-0.4	-0.3
Germany	1.8	-0.3	0.2	1.3	-0.7	-0.7
France	2.5	0.9	0.7	1.4	-0.6	-0.4
Italy	4	0.9	0.7	0.7	0	-0.3
Spain	5.8	2.5	1.9	2.1	0.2	0
Japan	1	1.9	0.9	1	-0.1	0.4
EMEs and developing economies	***4.1***	***4.3***	***4.2***	***4.2***	***0.2***	***0.1***
China	3	5.2	4.6	4.1	0.4	0
India	7	7.8	6.8	6.5	0.5	0.2
Russia	**-1.2**	**3.6**	**3.2**	**1.8**	**2.1**	**0.8**
Brazil	3	2.9	2.2	2.1	0.7	0.2
South Africa	1.9	0.6	0.9	1.2	-0.9	-0.4
Mexico	3.9	3.2	2.4	1.4	0.3	-0.1

Source: IMF.

GOVERNMENT BOND YIELDS IN LEADING ECONOMIES *Chart 1*
(%)



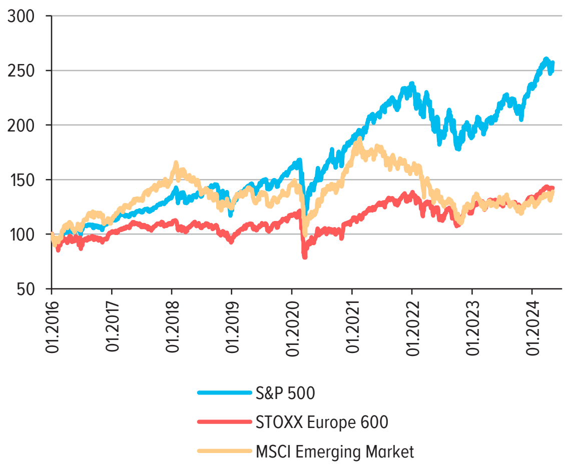
Source: Cbonds.

The situation in the world economy remains uncertain given unexpected inflation data increasing the risks that elevated inflation would turn out to be more persistent. Inflation in the USA sped up to 3.5% year-on-year (YoY) in March, edging down again to 3.4% YoY in April. Considering these figures, market participants are revising their expectations about the US Fed funds rate: in contrast to the beginning of the year when they expected three 0.25 pp reductions in 2024, market participants adjusted their expectations in May assuming that the rate would be cut by 0.25 pp only twice in 2024. As a result, long-term UST yields went up again (to 4.6% for 10-year maturities as of 2 May 2024). Yields in many countries remain elevated compared to the 2019–2021 averages (Chart 1). A potential acceleration of inflation might be provoked by higher energy commodity and food prices amid disruptions and rearrangement of logistics chains if geopolitical risks intensify, specifically in the Middle East. The Brent price equalled USD 84 per barrel as of 2 May 2024. High oil prices are supported by the OPEC+ additional oil production cuts.

Furthermore, the decisions on policy rates are becoming less synchronised. The ECB is expected to start cutting its policy rates in summer 2024. Many EMEs (Brazil, Chile) began reducing their policy rates already in H2 2023. So far, increases in US interest rates have not entailed realisation of risks in EMEs. However, sustained high interest rates or the risk of their rise in the USA might cause volatility spikes. In particular, in April 2024, Bank Indonesia suddenly increased its policy rate and announced foreign exchange interventions to stabilise the rupiah exchange rate. In March 2024, the Bank of Japan decided to end its long-term negative interest rate policy and its control over the yield curve. However, after the release of the March statistics on US inflation growth, the Japanese yen significantly weakened against the US dollar. Hence, differences in the pace of inflation deceleration and the views about monetary policy paths might cause changes in capital flow trends and sharp fluctuations of national currency exchange rates, while higher market volatility might in turn put pressure on financial sectors. Given the effective sanctions, these risks have become far less important to Russia. The threat might emerge if the problems spill over to global commodity markets or Russia's main trading partners face financial stability risks.

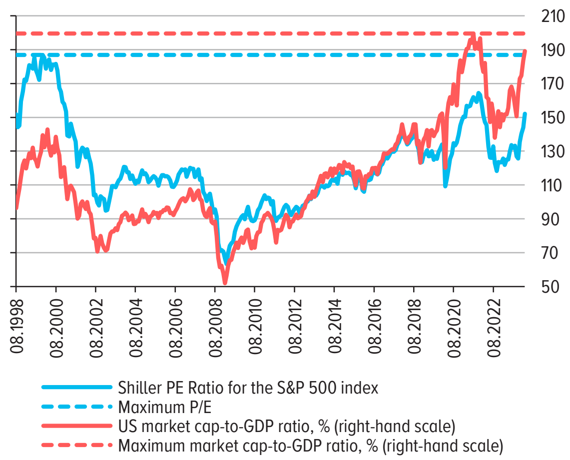
Nonetheless, expectations of policy rate reductions have been driving stock markets up so far. The US S&P 500 and the European Eurostoxx 600 indices hit new record highs exceeding the maximums of the end of 2021 (Chart 2). From the beginning of 2024 to 7 May, these stock indices were up by 8.8% and 7.3%, respectively. The accelerated growth of the stock markets amid the moderate recovery of the economies implies that the risks of overheating in the markets are

GLOBAL STOCK INDICES
(04.01.2016 = 100) *Chart 2*



Source: Cbonds.

US MARKET CAP-TO-GDP AND PRICE-TO-EARNINGS RATIOS *Chart 3*



Source: gurufocus.com.

CHANGES IN EMEs' KEY FINANCIAL MARKET INDICATORS *Table 2*

Country	Changes in EMEs' indicators over 1 January–7 May 2024			
	Exchange rates against USD	Stock index	10-year government bond yields	General ranking (1 – the worst, 15 – the best)
	%	%	bp	
Türkiye	-8.4	38.4	366	1
Thailand	-6.8	-3.4	8	2
Brazil	-4.3	-3.7	107	3
Chile	-6.2	6.1	64	4
Indonesia	-4.2	-2.1	47	5
Philippines	-3.2	2.6	83	6
Russia	-2.6	10.6	183	7
South Africa	-1.2	0.0	96	8
Hungary	-4.0	13.2	79	9
Malaysia	-3.0	10.4	18	10
Mexico	0.4	-0.5	64	11
Poland	-1.8	10.2	35	12
China	-1.9	5.8	-36	13
India	-0.3	1.8	-5	14
Colombia	-0.2	15.5	41	15
14 EMEs excluding Russia	**-3.2**	**6.7**	**69**	

Thresholds	Changes in indicators		
	Exchange rates against USD, %	Stock index (%)	10-year government bond yields (bp)
Minimum	-8.4	-3.7	-36
	0.0	0.0	0
Maximum	0.4	38.4	366

Source: Cbonds.

increasing. Thus, the US market cap-to-GDP ratio reached 188% coming close to record highs hit in August 2021, while the price-to-earnings ratio surged as well to 35.5 (Chart 3).

The MSCI Emerging Markets Index has stabilised, although is still below the levels of 2021 (Chart 2). Besides, since early 2024, national currencies in many countries have somewhat weakened against the US dollar, whereas government bond yields have risen (Table 2). The most significant vulnerabilities of the EMEs that are Russia's trading partners are described in Box 1.

High borrowing costs in global markets cause partial realisation of financial stability risks. Moreover, the scale of consequences might potentially increase, given the accumulated vulnerabilities.

- Major economies are facing a growing number of bankruptcies in the non-financial sector because of overdue debt growth and the termination of the support measures introduced during the pandemic. US bankruptcy filings (encompassing commercial and personal insolvencies) surged by 18% in 2023. The total number of bankruptcies in Canada (meaning those filed by both businesses and consumers) was up by 23.6% in 2023.
- High interest rates have adversely affected commercial real estate markets. The main reasons were higher borrowing costs, a reduction in investment, and lower real estate prices. Potential stress in commercial real estate markets might cause widespread consequences for banks and other financial intermediaries. At the beginning of 2024, the US bank NYCB was on the brink of bankruptcy due to the worsening quality of loans in commercial real estate (from February to 28 March 2024, NYCB's shares plummeted by 69%).[1] This case has also shown that other countries might face spillover effects. Specifically, Japan's Aozora Bank said that it was exposed to risks related to US real estate. Julius Baer, the second largest Swiss bank, faced an over 50% plunge in its profits after having written off CHF 606 million due to its exposure to the Austrian property group Signa that had become bankrupt.
- Fiscal and debt risks are still significant (especially in advanced economies). As assessed by the IMF,[2] the global public debt-to-GDP ratio rose from 91.3% in 2022 to 93.2% in 2023, remaining higher than before the pandemic (84.2% in 2019). Increased public debt, high borrowing costs, and budget deficits are limiting room for manoeuvre. If the support programmes are expanded further while interest rates remain high, the probability of debt crises and fiscal dominance might grow and negative feedback effects might arise between the financial and real sectors. Russia's public debt-to-GDP ratio remains low (14.9% as of 1 January 2024)[3] compared to other EMEs (according to the IMF, the ratio for the EMEs within the G20 equalled 73.5%).

Hence, the world economy's prospects are still highly uncertain. Potential shocks (including fragmentation, geopolitical and climate risks) are proinflationary in contrast to the globalisation that had disinflationary effects in previous years.

[1] NYCB is a rather large bank having USD 116 billion of assets, a considerable portion of which are non-performing loans. In 2023, NYCB acquired the assets of the bankrupt Signature Bank totalling USD 38.3 billion.

[2] IMF, Fiscal Monitor, April 2024.

[3] The calculations are based on the statistics of Russia's Ministry of Finance on external and internal public debt and Rosstat's information on annual GDP as of 1 January 2024.

Box 1. Estimates of macroeconomic stability of some Russian trading partners

The macroeconomic situation in the countries that are Russia's main trading partners generally remains stable despite the persisting vulnerabilities and occasional volatility spikes in the markets.

China recorded a certain economic revival in early 2024. In April, exports expanded by 1.5% YoY (vs a decline by 7.5% YoY in March and a rise by 7.1% YoY over January–February 2024) and imports increased by 8.4% YoY (vs a decline by 1.9% YoY in March and a rise by 3.5% YoY over January–February 2024). The growth rate of consumer prices remains close to zero (equalling 0.3% YoY in April 2024), whereas producer prices continue to trend downwards (-2.5% YoY in April). The rise in the stock market's volatility at the beginning of the year was limited owing to a set of measures, including the establishment of the stabilisation fund of CNY 2 trillion to acquire Chinese companies' shares, the introduction of a number of restrictions on share sales by institutional investors and on retail investors' access to the funds investing in foreign securities, and the engagement of government funds and financial institutions in share acquisitions. However, vulnerabilities still persist in the real estate sector where the government continues to implement the support package that includes easing of the mortgage rules and measures to buy excess inventories from developers.

Türkiye is still experiencing persistent macroeconomic imbalances. Amid high inflation, the Turkish lira continues to depreciate (by 8.4% from the beginning of 2024 to 7 May). In April 2024, inflation was 69.8% YoY and 3.2% MoM. The Central Bank of the Republic of Türkiye raised its policy rate by 5 pp to 50% in March 2024. There is still a deficit of the current account (4.3% of GDP in 2023). Nevertheless, the Fitch and S&P rating agencies upgraded Türkiye's credit rating to 'B+' (in March and May 2024, respectively), having noted higher confidence in the stability and efficiency of the country's policy pursued since June 2023.

India's GDP growth rate remains high (7.8% in 2023 and, as forecast by the IMF, 6.8% in 2024). Annual inflation slowed down to 4.8% in April 2024. High oil prices and steady domestic demand might entail an increase in spending on imports and the current account deficit.

Kazakhstan's economy is positively influenced by favourable prices for exports. Besides, annual inflation continues to decelerate (8.7% in April 2024). In these conditions, the National Bank of Kazakhstan had been cutting its policy rate since July 2023 by a total of 2 pp to 14.75% as of April 2024.

2. VULNERABILITIES AND RESILIENCE OF THE RUSSIAN NON-FINANCIAL SECTOR

2.1. Intensifying sanction pressure on Russia and friendly countries

In Q4 2023–Q1 2024, unfriendly states strengthened the sanction pressure. Their new restrictions were targeting not only Russian companies but also businesses from friendly countries. These sanctions might decrease exports and imports, adversely affect the profit margin on Russian goods and their competitiveness in the global market, as well as make logistics and cross-border payments more complicated.

Oil and gas production and exports, as well as petroleum products exports contracted as of the end of 2023. Companies continue to adapt to the sanctions and are expanding transactions in the East. However, they have not yet managed to fully offset the decline in exports. Unfriendly countries are hampering not only the sale of extracted hydrocarbons but also the implementation of major investment projects.

The intensifying sanction pressure has hit other industries too. The restrictions imposed are also forcing non-ferrous metal, mining and quarrying, and diamond enterprises, as well as other exporters to search for new markets. Secondary sanctions are complicating supply chains and payment schemes, which is making imports more expensive and disrupting supplies.

In 2023, the Russian corporate sector continued to adjust to the sanction pressure and the new business environment. Another cycle of the sanctions included the intensification of the secondary sanctions and the tightening of the restrictions enacted earlier.

The threat of secondary sanctions is forcing counterparties from friendly states to mitigate their risks, which sometimes makes them refuse to continue cooperation with Russian companies and their related entities. More complicated supply chains and payment schemes are making imports more expensive, increasing input costs and disrupting supplies, which is reducing the profit margin on Russian companies' products and their competitiveness in international markets. Furthermore, as the use of the international payment infrastructure is restricted, it is necessary to diversify and expand settlement channels.

On 18 December 2023 and 23 February 2024, the EU adopted the 12th and the 13th packages of economic and individual sanctions. Besides, the USA imposed new sanctions against a whole range of sectors of the Russian economy. Moreover, in April 2024, the USA prohibited the import of Russian-origin aluminium, copper, and nickel. The new restrictions might have a negative effect on diamond, oil and gas, non-ferrous metal, and mining and quarrying enterprises. The contraction of exports by the quantities previously supplied to unfriendly states might adversely affect the financial position of companies in the said sectors. Their stability will depend on their capabilities to redirect sales to new markets as well as government support measures in a number of cases.

Situation in particular industries

1. Oil and gas production. In Q4 2023 – Q1 2024, companies were facing difficulties with cross-border settlements for exported Russian oil and petroleum products because of the intensifying sanction pressure on friendly states' banks.

Moreover, the industry is still affected by the OPEC+ oil production cuts. Oil production and exports shrank as of the end of 2023. Petroleum products exports contracted as well as of the end of last year. The Asia-Pacific Region countries accounted for the largest part of the supplies.

In Q2 2024, the Russian Federation plans to reduce production further in coordination with other OPEC+ countries.

Russian crude is still sold at a discount to the global price. Over November 2023–January 2024, the discount rose from 11% to 18% amid the sanctions against individual vessels and traders selling Russian crude. During the next few months, the discount was hovering around 15–17%.[1]

In 2023, the EU was reducing Russian natural gas imports further. According to Rosstat, Russia produced 638 billion cubic metres over 2023, which is 5.6% less YoY.[2] Natural gas exports decreased over the said period as well. Contrastingly, gas supplies through the Power of Siberia pipeline to China during this period surged to a record high. However, the existing infrastructure for gas exports to China is still limited, while there is no precise schedule for the launch of the construction and commissioning of the Power of Siberia-2 pipeline.

Total liquefied natural gas (LNG) exports contracted in 2023 compared to 2022. European countries continued to offset the decline in pipeline natural gas supplies with LNG imports from Russia, while discussing restrictions on new LNG contracts. LNG exports to Asia dropped as well in 2023. From the beginning of 2024, LNG output has been growing. However, its expansion is hindered by the US sanctions against shipbuilders which might cause delays in ship building, increase capital expenditures, and make it difficult to find LNG buyers.

2. Passenger air transportation. Airlines continue to adjust to the current sanctions. The passenger flow increased by 10% YoY to 105 million people in 2023 and by 8.3% YoY to 23 million in Q1 2024, having exceeded the targets stipulated in the baseline scenario of the comprehensive programme for the development of the Russian aviation industry.[3] The programme provides for the construction of 609 domestic long-haul and regional aircraft to be supplied no earlier than 2025. The funding for the programme will approximate RUB 1 trillion.[4] The Russian Government plans to allocate RUB 283.3 billion for its implementation until 2023 from the National Wealth Fund. The money will be used to upgrade the plants, establish logistics centres, manufacture aircraft components, and purchase software. The restrictions enacted against individual companies might decrease the passenger flow on international flights.

3. Diamond production. The sanction pressure on the diamond industry intensified in H2 2023. In December, the EU banned the direct and indirect import, purchase and transit of diamonds and diamond jewellery from Russia. The rough diamond certification scheme to prevent the sale of Russian-origin diamonds to the Western markets will become effective from 1 September 2024. The industry's stability will depend on its capabilities to redirect Russian diamonds to friendly states' markets. To support demand and offset the decline in the largest companies' profits, the Russian Ministry of Finance concluded the agreement for purchasing rough diamonds from enterprises throughout 2024.[5]

4. Coal production. According to the Ministry of Energy of the Russian Federation, coal output edged down by 1.26% YoY to 438 million tons in 2023, which was attributed primarily to the suspension of operation of some large mines[6] and lower demand from China at the end

[1] The Bank of Russia's calculations based on data from the Ministry of Economic Development of the Russian Federation and Finam.

[2] According to Rosstat, the production of natural gas and associated petroleum gas totalled 533 billion cubic metres and 105 billion cubic metres, respectively (-7.5% and +4.3% YoY, respectively).

[3] Resolution of the Government of the Russian Federation No. 1693-r, dated 25 June 2022, 'On Approving the Comprehensive Programme for the Development of the Russian Aviation Industry Until 2030' (as amended on 22 August 2023).

[4] Resolution of the Government of the Russian Federation No. 7-r, dated 13 January 2024.

[5] The fist transaction under the agreement was made in March 2024: Gokhran of Russia bought a batch of diamonds, including the entire cut of production, from PJSC ALROSA.

[6] Kuzbass accounts for over a half of coal output in Russia. In 2023, production in this region shrank by 4.2% YoY to 214.2 million tons due to the suspension of operation of large mines.

of 2023. In Q1 2024, Russian coal imports to China plummeted by 21.8% YoY[7] to 18.4 million tons following the introduction of the import duties. Because of lower demand in Asian markets, Russian coal enterprises are selling their products at a discount to international benchmarks. Amid the unfavourable situation in the market, higher tax burden and rising logistics costs, the largest coal producers might face a decline in output, profit margins and financial performance. In April 2024, the Russian Government decided to cancel the export duties on thermal coal and anthracite for the period from 1 May 2024 through 31 August 2024 in order to support theindustry.

5. Auto manufacturers. Despite tight monetary conditions, the demand for new cars continued to rebound, although it is still below the 2021 level. Sales surged by 69% YoY to 1.06 million cars in 2023 and by 93% YoY to 330,700 cars in Q1 2024. These were mostly Chinese models. The expansion of the market is driven by increasing car lending (for details, see Subsection 3.2 'Growth of households' debt burden'). The largest Russian car and truck makers continue to expand vehicle sales and remain the leaders in their respective segments. However, their share in the sales has been shrinking gradually due to soaring supplies from Chinese manufacturers.

6. Commercial real estate. Although foreign companies exited the Russian market, the commercial real estate market continues to restore, with some segments surpassing the pre-crisis level of 2021. Over 2023, the proportion of vacant areas in Moscow shopping malls decreased by 7.2 pp to 8.4%[8] as new brands from friendly states were entering the market and Russian retailers were developing their business (vs 13.7% in 2021). The warehouse vacancy rates dropped to minimums: by December 2023, the vacancy rate in Russian regions edged down to 0.4% (vs 1.9% in 2022 and 3.2% in 2021) and that in the Moscow metropolitan area to less than 0.1% (vs 0.4% in 2021 and 1.8% in 2022). The office space market also continues to bounce back, while still failing to reach the 2021 level.[9] Despite the recovery in the industry and the filling of vacant spaces, the area of new commercial real estate commissioned in 2023 contracted by 69% vs 2021 to 275,500 square metres.

2.2. Assessment of Russian non-financial companies' resilience

In 2023, the majority of the Russian largest non-financial organisations improved their profitability and debt burden indicators. However, some major non-financial companies are facing a decline in financial performance. According to the 2023 reporting, non-financial organisations were less sensitive to interest rate risk than in the middle of the year. Most borrowers have sufficient operating earnings to service their loans in 2024.

Analysis of the Russian largest non-financial companies' financial position[10]

Despite the growing sanction pressure from Western countries, most companies in the Russian largest industries have either reduced their debt burden or maintained their financial indicators at the earlier level. The exceptions are some major non-financial companies primarily from the oil and gas, non-ferrous metal and fertiliser industries whose financial resilience has worsened (Chart 4). The aggregate net debt-to-EBITDA ratio for the oil and gas industry edged up by 0.4 to 1.2, predominantly because some companies increased debt while reducing export earnings and profits. Net debt / EBITDA in the non-ferrous metal industry rose by 0.7 to 1.8. The growth was associated with the new sanctions forcing individual companies to reduce sales and build up inventories as well as to raise new loans to reorganise their business (including changing the jurisdiction).

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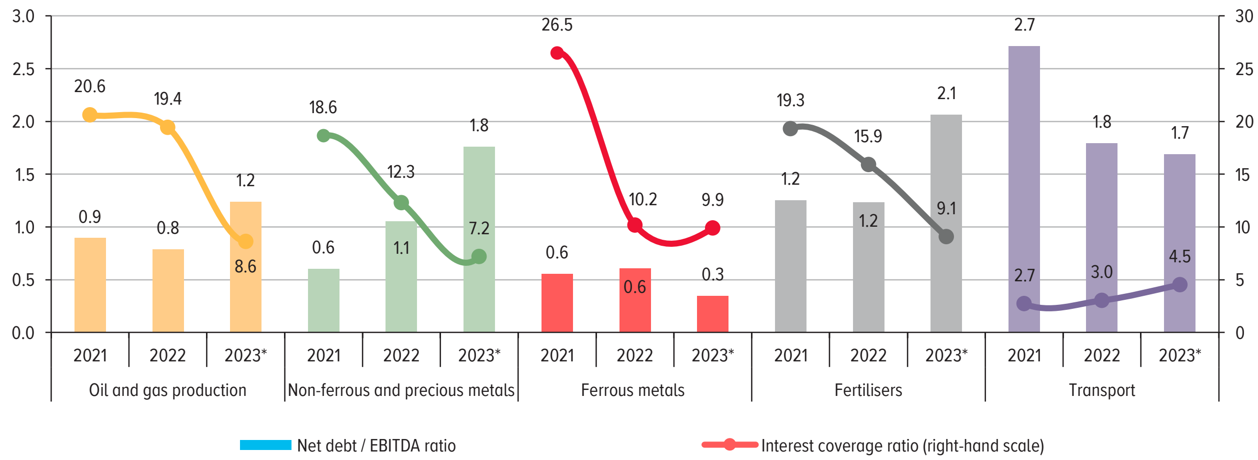
7 As reported by China Customs.

8 According to NF Group (previously, Knight Frank).

9 As of the end of 2023, the vacancy rate in Moscow edged down from 13.0% to 12.4% for A-class offices and from 7.4% to 6.9% for B-class offices, compared to 9.5% and 5.6% in 2021, respectively.

10 Aggregate financial indicators of profitability and debt burden within the analysis of the Russian largest non-financial companies' financial position were calculated for the largest public companies representing the industries under review.

AGGREGATE DEBT INDICATORS FOR CERTAIN INDUSTRIES IN 2021–2023 *Chart 4*



** The data are given for the companies that published their IFRS statements for 2023.*
Sources: companies' IFRS reporting, Bank of Russia calculations.

Net debt / EBITDA in fertiliser production increased by 0.9 to 2.1, which was associated with new working capital loans raised by companies due to extended turnover periods of receivables and advances paid, as well as interim dividend payouts.

The aggregate net debt-to-EBITDA ratio in ferrous metallurgy edged down by 0.3 to 0.3, which was associated with the redirection to new export destinations and improvement in operating performance. Net debt / EBITDA in transportation dropped by 0.1 to 1.7 primarily as a result of the increase in the passenger flow by 10.3% YoY in air transportation driven by rebounding demand.

The decrease in the interest coverage ratio across industries was attributed to the tightening of monetary conditions in 2023. Nevertheless, most companies have no difficulties servicing their debts and maintain financial resilience.

Box 2. Influence of tight monetary policy on major companies

The Bank of Russia carries out regular assessments of the corporate sector's sensitivity to monetary tightening. The assessment perimeter embraced approximately 80 largest non-financial companies (from 13 industries) whose consolidated earnings over the past 12 months[1] totalled RUB 68.7 trillion (40% of GDP over 2023) and consolidated debt – RUB 36.6 trillion (44% of the non-financial sector's debt).[2]

To assess the corporate sector's sensitivity to key rate changes, the Bank of Russia uses the interest coverage ratio characterising how well a company can pay the interest due on outstanding debt. The ratio above 1.0 is considered to be allowable.[3]

According to the data in the IFRS financial statements for 2023, most companies improved their financial and operating performance and became less sensitive to interest rate risk. The number of companies whose interest coverage ratio over the past 12 months was less than 1.0 dropped to 10 (vs 11 as of 30 June 2023). If the key rate remains at the lower bound of the forecast range in 2024,[4] the number of companies that might need debt restructuring increases from 10 to 12 (vs 15 as of 30 June 2023). As of 31 December 2023, these additional two companies' consolidated debt totalled RUB 0.17 trillion (0.5% of the outstanding debt of the companies in the sample).

If the key rate is kept at the upper bound of the forecast range in 2024, the number of distressed companies increases from 10 to 14 (vs 19 as of 30 June 2023). As of 31 December 2023, these additional four companies' consolidated debt totalled RUB 0.7 trillion (1.9% of the outstanding debt of the companies in the sample).

Hence, according to the results of 2023, companies' sensitivity to interest rate risk decreased, while most borrowers have sufficient operating earnings to pay interest on their loans in 2024.

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1 Based on data from the latest IFRS statements published by companies; all indicators are given in annualised terms.

2 According to the data on the aggregate measure of the non-financial sector's debt as of 1 January 2024.

3 For details about the assessment of the corporate sector's sensitivity to key rate changes, refer to the information and analytical review Financial Stability Review No. 2 (23) for Q2–Q3 2023, page 21.

4 According to the Bank of Russia's medium-term forecast, dated 26 April 2024, the key rate in 2024 is forecast in the range from 15.0% to 16.0% per annum.

3. VULNERABILITIES OF THE RUSSIAN FINANCIAL SECTOR

3.1. Structural imbalances in the domestic FX market

In Q4 2023–Q1 2024, the ruble exchange rate was supported by the stable current account surplus and sustained tight monetary policy.

The trend towards a decline in correspondent relationships with non-resident banks in 'toxic' currencies continued. However, the expansion of correspondent relationships in 'non-toxic' currencies slowed down amid the threat of secondary sanctions that might be imposed by unfriendly states.

The decline in Russian banks' balances in correspondent accounts with foreign banks was accompanied by the growth of lending in yuan to corporate clients and difficulties with yuan liquidity on certain days. Yuan borrowing costs were rising for a short while at the end of the month and quickly returned to normal values, thus involving no systemic risks.

The FX regulation in China and the risks of secondary sanctions are limiting the opportunities to raise external funding in yuan. Therefore, domestic savings remain the main source of funding of yuan-denominated assets for financial market participants. Being the last-resort creditor, the Bank of Russia can maintain the level of foreign currency liquidity to ensure financial stability. In March 2024, the Bank of Russia increased the daily limit for FX swaps on the days of the peak demand for yuan from CNY 10 billion to CNY 20 billion and made the decision to raise the cost of yuan borrowings by 100 basis points. The swap with the Bank of Russia to sell yuan for rubles helps moderate excessive volatility in the FX money market, while the regulator seeks to mitigate the impact of its operations on market pricing.

1. Factors stabilising the ruble exchange rate

Given the existing capital controls, the situation in the Russian FX market is primarily influenced by the state of the current account. A key factor is the ratio between importers' demand for foreign currency and exporters' supply of foreign currency, while exporters' foreign currency earnings mostly depend on global prices for crude oil and other commodities.

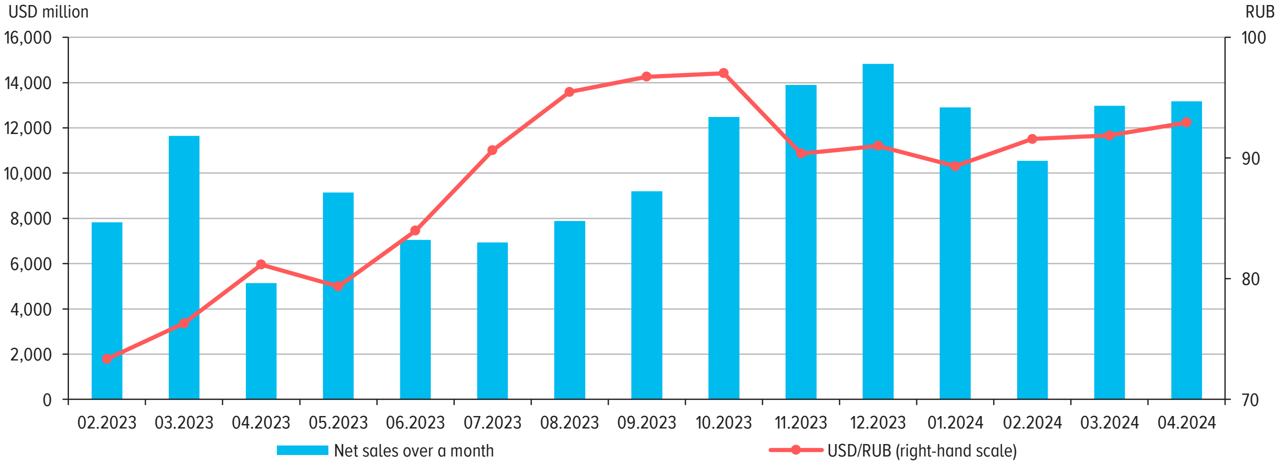
The Bank of Russia monitors the amounts of foreign currency purchases and sales by the Russian largest exporters. Net foreign currency sales (sales net of purchases) increased in November–December 2023. The sample of the 29 Russian largest exporters accounted for USD 13.9 billion in November 2023 and USD 14.8 billion in December 2023. In November and December 2023, the ratio of net foreign currency sales to foreign currency export earnings equalled 88% and 93%,[1] respectively.

The growth of foreign currency earnings and net sales was driven primarily by rising oil prices: according to the Russian Ministry of Finance, the Urals price averaged USD 77 per barrel in October–November 2023, which is 30% higher than the average over January–September 2023. Contrastingly, the decline in oil prices over December 2023–January 2024 to the average of USD 64 per barrel entailed a reduction in export earnings and foreign currency sales by exporters in January–February 2024 (crude export earnings are credited to exporters' accounts with an average time lag of one to two months). As a result, the average monthly amount of net foreign currency

[1] The values may be adjusted considering the updated information from contracts registered by authorised banks in accordance with Bank of Russia Instruction No. 181-I, dated 16 August 2017, 'On the Procedure for Residents and Non-residents to Submit Documents and Information Confirming Foreign Exchange Transactions to Authorised Banks, on Single Accounting and Reporting Forms Related to Foreign Exchange Transactions, and the Procedure and Timeframes for Their Submission'.

NET SALES OF FOREIGN CURRENCY BY LARGEST EXPORTERS* AND USD/RUB EXCHANGE RATE

Chart 5



* *Data on the 29 largest exporters.*
Sources: credit institutions' survey about the amounts of purchases / sales of the largest exporters' foreign currency earnings, Moscow Exchange.

sales over January–February 2024 in the reviewed sample of companies declined to USD 11.7 billion, which is USD 3.1 billion or 21% less than in December 2023 (Chart 5), while still significantly more than in summer 2023.

The recovery in oil prices in February–March 2024 to USD 68–70 per barrel and the receipt of the export earnings delayed due to the intensifying sanction pressure caused an increase in net foreign currency sales by 23% MoM to USD 13.0 billion in March and by 2% MoM to 13.2 billion in April.

Furthermore, the expansion of net foreign currency sales by exporters at the end of 2023 was associated with the tightening of the Bank of Russia's monetary policy which made ruble savings more attractive to both individuals and corporates. In the conditions of the high key rate, some companies began to increase foreign currency loans converting foreign currency earnings into rubles. In addition, the growth of foreign currency sales was driven by one-off factors, including the conversion of foreign currency funds by some major companies to pay dividends.

Excluding the influence of the one-off factors resulting in the expansion of foreign currency sales by a number of exporters, the ratio of net foreign currency sales (sales net of purchases) to foreign currency export earnings of the largest exporters over November 2023–February 2024 would be 80%, which is close to the average of 82% recorded over 2022–2023.[2]

2. Dynamics of correspondent relationships

The decline in correspondent relationships in 'toxic' currencies with non-resident banks continued during the period under review. As of 1 April 2024, the index of the network of correspondent relationships with non-residents in 'toxic' currencies decreased by 17% and 55% compared to 1 October 2023 and early 2022, respectively. The positive trend in correspondent relationships in friendly countries' currencies observed since 2022 slowed down because of the sanctions enacted by the USA in December 2023 which had complicated Russian banks' interaction with credit institutions from a number of friendly states.

[2] Taking into account the influence of the one-off factors, the ratio of net foreign currency sales to foreign currency export earnings of the reviewed exporters equalled 89%. This figure is published in the information and analytical review Financial Market Risks Review on the Bank of Russia's website.

Box 3. Risks of individuals' investment in foreign instruments

Beginning from 2019, the Bank of Russia's Financial Stability Review has been highlighting the vulnerability related to growth in individuals' balances in deposits with non-resident banks, investment in foreign securities, and money transfers to foreign brokers. The risks of the freezing of foreign shares held by Russian investors realised as a result of the sanctions enacted by the USA against PJSC SPB Exchange during the period under review, in addition to the restrictions imposed earlier by unfriendly states' depositories and the EU's sanctions against National Settlement Depository (NSD). PJSC SPB Exchange is working with the Office of Foreign Assets Control (OFAC) on the mechanism for unblocking the assets.[1] As regards the frozen foreign securities recorded through NSD, the Government of the Russian Federation and the Bank of Russia took action to provide opportunities to exchange the frozen securities. The Russian President signed an executive order[2] allowing Russian private resident investors to sell the frozen foreign securities to non-residents in the amount of up to RUB 100,000.[3]

Over the period under review, the vulnerability associated with individuals' foreign investment continued to decrease: households' savings in foreign financial instruments, adjusted for foreign currency revaluation, declined by 0.6 pp to 18.5% (Chart 6). The proportion of individuals' funds in foreign financial instruments (predominantly in foreign currency deposits with non-resident banks) equalled 12.5% in total investment over the period under review and 8.4% for all of 2023, which is considerably less than 35.2% in 2022.

As the Bank of Russia maintained tight monetary policy, people's ruble deposits were up by RUB 6.57 trillion over the period under review, accounting for 79.4% of overall investment in financial instruments. Thus, the accumulated vulnerabilities have realised, whereas new ones are not forming actively, which is why this risk is not highlighted as a separate vulnerability in the Financial Stability Review.

Nevertheless, **Russians increased their activity in the cryptocurrency market** in Q4 2023–Q1 2024, which might be because cryptocurrency exchange rates went up. Russian users visited the websites of the largest cryptocurrency platforms (crypto exchanges, P2P platforms, and cryptocurrency exchange offices) 104.6 million times over the reporting period, that is, total web traffic on these websites increased by 16.4% compared to Q2–Q3 2023. Concurrently, the average monthly number of unique users (IP addresses) of the largest crypto exchanges rose by 15.1%. The proportion of Russians in the overall number of the visits was up as well over Q1 2024, specifically by 7%, while still staying below the peak of 9% recorded in Q1 2023. During the period under review, the inflows and outflows[4] of cryptoassets (BTC, ETH, USDT, and USDC) potentially accounted for by Russians expanded by 15.6% vs Q2–Q3 2023 to total RUB 4.5 trillion.[5]

The structure of the market of crypto exchanges used by Russians has changed. As Binance exited the Russian market, Russians' web traffic has redistributed. In Q3 2023, Binance accounted for 47% of Russians' total web traffic, while in Q1 2024, this percentage plummeted to 16%. In addition, the share of the five popular crypto exchanges focusing on developing markets surged from 39% in Q3 2023 to 64% in Q1 2024.

Cryptocurrency risks for individuals remain. In the first place, as the Bitcoin price rose, its volatility increased as well, in particular from 23.4% at the end of Q3 2023 to 80% at the end of Q1 2024.[6] Second, it is necessary to take into account risks associated with potential sanctions that might be imposed by unfriendly states. The funds might become inaccessible if blocked by stablecoin issuers. The USA and the UK are reviewing USDT transactions and tightening control over crypto exchanges (for details, see the Annex). In addition to Binance, global cryptocurrency exchange KuCoin was criminally charged by the US Department of Justice. Other crypto exchanges might tighten control over users' transactions, including as part of the sanctions.

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1 The website providing information on asset unlocking.

2 Executive Order of the Russian President No. 844, dated 8 November 2023.

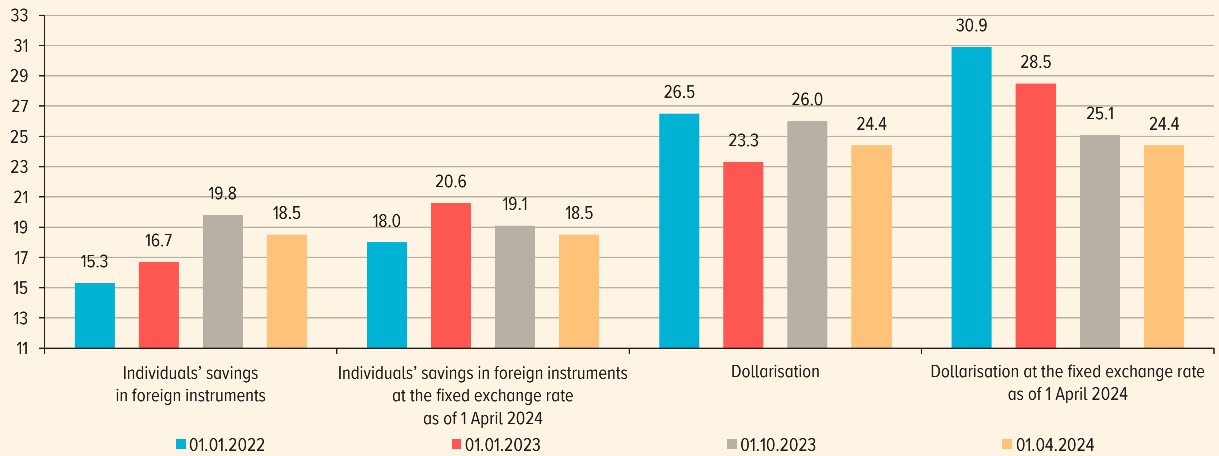
3 For details, refer to the exchange's website.

4 This indicator measures the turnover of transactions (that is, flows of users' funds across accounts). The inflows and outflows may be related to payments for goods and services, cryptocurrency transfers to exchanges for sale, transfers between users, as well as withdrawals of cryptocurrency to a decentralised wallet after its purchase in the P2P market, and other purposes.

5 The source of the data given in this and next paragraphs is Transparent Blockchain, a system monitoring cryptocurrency transactions (its new commercial name is Inchain).

6 Data provided by The Block.

INDIVIDUALS' SAVINGS IN FOREIGN INSTRUMENTS* AND DOLLARISATION** OF INDIVIDUALS' SAVINGS *Chart 6*
(%)



** Calculated as the ratio of the overall amount of individuals' money transfers to non-resident banks and non-resident brokers, foreign currency cash and foreign securities to individuals' total investment in financial instruments.*
*** Foreign securities, Russian issuers' foreign currency-denominated securities, foreign currency deposits, money transfers to non-resident brokers and banks, and foreign currency cash.*
Sources: Reporting Forms 0409711, 0420415 and 0409405; households' saving rate.

In view of the above risks, the Bank of Russia published its recommendations[7] to financial institutions. Specifically, they are advised not to admit cryptoasset-linked financial instruments to trading, not to advertise any services related to the turnover of cryptoassets, and to detect transactions to buy and sell cryptoassets using dummy accounts.

[7] Bank of Russia Information Letter No. IN-018-34/17, dated 29 February 2024, 'On Certain Types of Financial Instruments and Digital Financial Assets'; Bank of Russia Information Letter No. IN-08-12/18, dated 29 February 2024, 'On Risks of Digital Currency Transactions and Recommendations to Financial Institutions not to Offer Services Related to Such Transactions'; and Bank of Russia Methodological Recommendations No. 4-MR, dated 29 February 2024, 'On Increasing Control over Certain Customer Transactions'.

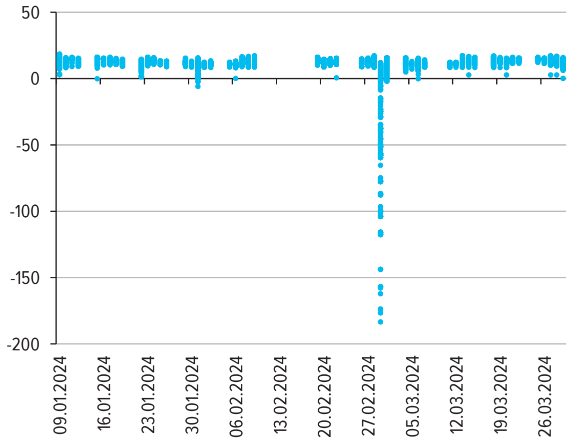
Worsening of the foreign liquidity situation

In December 2023, the expansion of lending in yuan started to exceed the growth rate of yuan raised, which was accompanied by a reduction in banks' liquid yuan-denominated assets. Besides, banks were increasingly relying on short-term funding through FX swaps. The FX swap market is used by participants to finance foreign currency assets, in the first place, and to raise yuan for settlements under foreign trade contracts, in the second place.

From October, yuan balances were shrinking, which decreased donor banks' capabilities to supply liquidity in the FX swap market. A number of large banks previously providing yuan liquidity began to raise it in Q1 2024. In December 2023, some providers started to close the yuan lending positions on the last trading day of the month to rebalance the indicators as of the reporting dates.

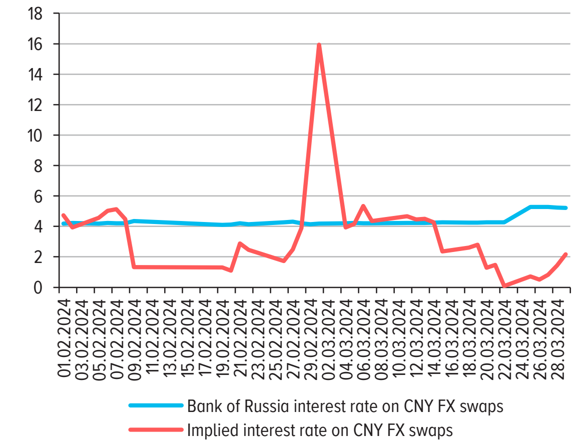
During the period of elevated demand, market participants were raising yuan through the Bank of Russia's FX swaps. The demand for yuan was the highest at the end of February 2024 when the swap difference (in per cent per annum) for certain transactions in the market exceeded 180% (Chart 7), while the daily limit on the Bank of Russia's FX swaps was completely exhausted. Interest rates on CNY/RUB FX swaps (as regards the cost of yuan provided) frequently exceeded the levels of the Bank of Russia's support, as a result of which the Bank of Russia's applications for providing yuan liquidity were activated (Chart 8). The concentration of the Bank of Russia's counterparties on FX swap transactions was relatively low, which is evidence that the demand for additional yuan liquidity was demonstrated by the market in general rather than only a number of large participants. Nevertheless, the sharp rises in the yuan swap difference were short-term and the situation quickly returned to normal, as a result of which there were no systemic risks in the market for CNY/RUB FX swaps.

SWAP DIFFERENCE* FOR CNY/RUB_TODTOM *Chart 7*
(% P.A.)



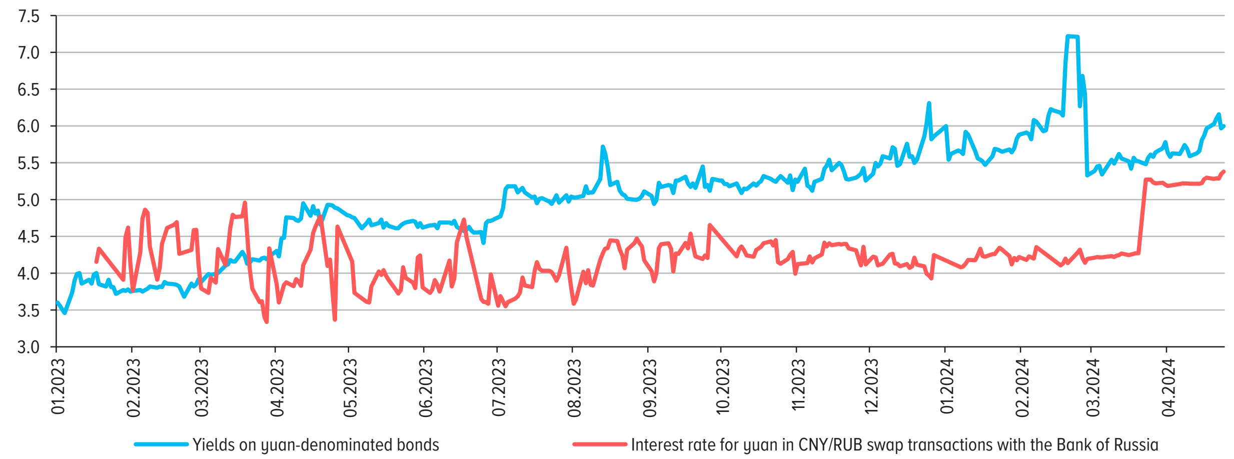
** Each point in the chart is a separate transaction.*
Source: Moscow Exchange.

IMPLIED INTEREST RATE ON CNY/RUB FX SWAPS AND INTEREST RATE ON THE BANK OF RUSSIA FX SWAPS *Chart 8*
(%)



Source: Bank of Russia calculations.

YIELDS ON YUAN-DENOMINATED BONDS AND THE YUAN LENDING RATE ON THE BANK OF RUSSIA FX SWAPS *Chart 9*
(%)



Source: Bank of Russia.

Given the capital controls in China, domestic savings might be the main source of funding of yuan-denominated assets in Russia. In addition, limited access to external financing and difficulties with yuan payments were the factors behind the steady rise in yields on yuan-denominated bonds in the Russian market throughout 2023 (Chart 9).

To moderate excessive volatility in the FX money market, the Bank of Russia decided to expand the daily limit on FX swaps for the last and first two business trading days of each month from CNY 10 billion to CNY 20 billion. Besides, the cost of yuan borrowings under FX swaps was raised by 100 bp in order to mitigate the impact of the Bank of Russia's transactions on market pricing.

3.2. Growth of households' debt burden

Despite the Bank of Russia's tight monetary and macroprudential policies, unsecured consumer lending is still expanding fast (17% YoY as of 1 April 2024): over January–February 2024, the monthly growth rate of the loan portfolio was 0.9%, whereas in March, it rose to 1.8%. Nevertheless, the MPLs improved the unsecured consumer lending standards: the proportion of loans issued to

borrowers with DSTI above 80% contracted from 27% in Q1 2023 to 13% in Q1 2024 and that to borrowers with DSTI of 50–80% decreased from 35% in Q1 2023 to 21% in Q1 2024.

Over Q1 2024, the growth of the consumer loan portfolio was driven by the segment of credit cards where the MPLs have a time-lagged effect. A considerable percentage of debt on credit cards (73%[3] as of 1 April 2024) is accounted for by cards opened before the introduction of the MPLs (in 2022 and earlier). In the conditions of the key rate increase and the suspension by the Bank of Russia of the limit on the EIR for consumer loans,[4] more financially sound borrowers reduced the demand for loans. However, banks increased disbursements to higher-risk borrowers (including to individuals with low DSTI but without a credit history or with overdue payments in their histories) offsetting the additional risk with higher credit rates. The leading indicators suggest a decrease in the quality of servicing by borrowers of the cash loans issued at high interest rates from the beginning of Q3 2023.

As of the end of Q1 2024, car lending soared by over 50% in annualised terms, which was accompanied by an increase in borrowers' debt burden: the proportion of car loans issued to borrowers with DSTI above 50% rose from 45% in Q4 2022 to 61% in Q1 2024.

To improve banks' stability in the conditions of worsening loan servicing quality, from 1 July 2024, the Bank of Russia raises the macroprudential risk-weight add-ons for consumer and car loans.

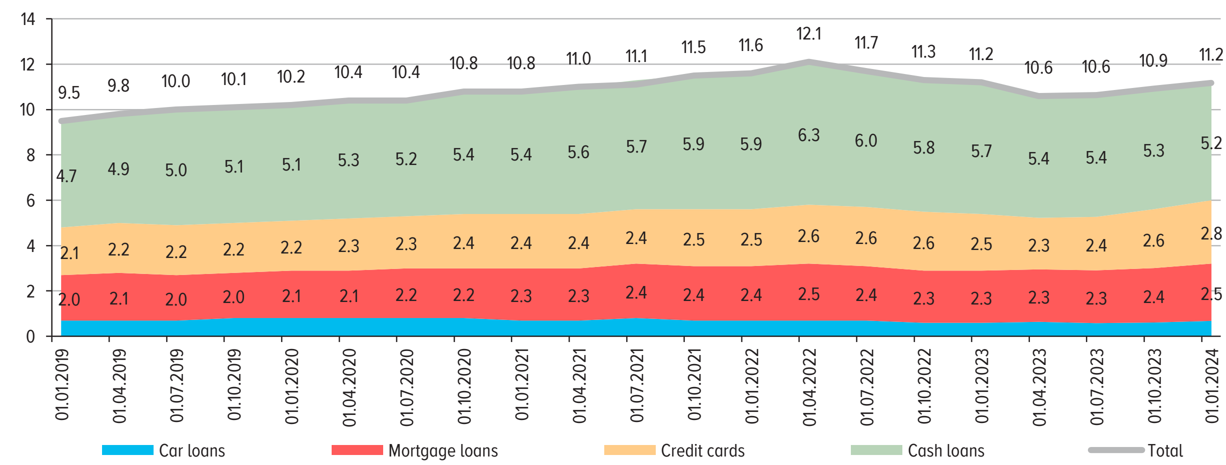
1. Households' debt burden at the macrolevel

Households' debt burden at the macrolevel remained the same over 2023, equalling 11.2% as of 1 January 2024 (Chart 10). Debt burden across lending segments was changing diversely. In particular, as a result of the MPLs, debt burden on cash loans decreased by 0.5 pp over 2023. Contrastingly, debt burden on credit cards was up by 0.3 pp over the said period, while outstanding debt surged 1.5 times.

Following the surge in the mortgage portfolio (+34.5% YoY as of 1 January 2024), borrowers' debt burden on mortgage loans increased by 0.2 pp. The growth of outstanding debt was partially offset by the extension of the average mortgage maturity to 19 years. The car loan portfolio soared 1.4 times over the year, contributing 0.7 pp to the overall debt burden.

DEBT SERVICE RATIO IN RETAIL LENDING
(%)

Chart 10

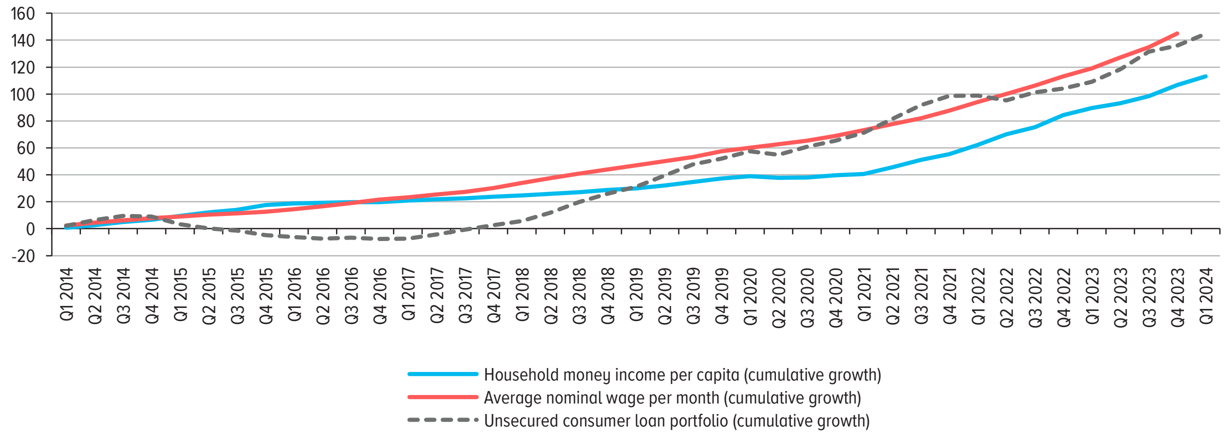


Sources: CHBs' data, Reporting Forms 0409316, 0409126, 0409128 and 0409102, Rosstat.

[3] According to CHBs' consolidated data.

[4] Decisions of the Bank of Russia Board of Directors, dated 16 August 2023 and 15 December 2023. The moratorium will be effective through Q2 2024.

CUMULATIVE GROWTH OF HOUSEHOLD MONEY INCOME PER CAPITA, AVERAGE NOMINAL WAGE PER MONTH, AND THE UNSECURED CONSUMER LOAN PORTFOLIO *Chart 11*
(%)



Sources: Rosstat, Reporting Form 0409115.

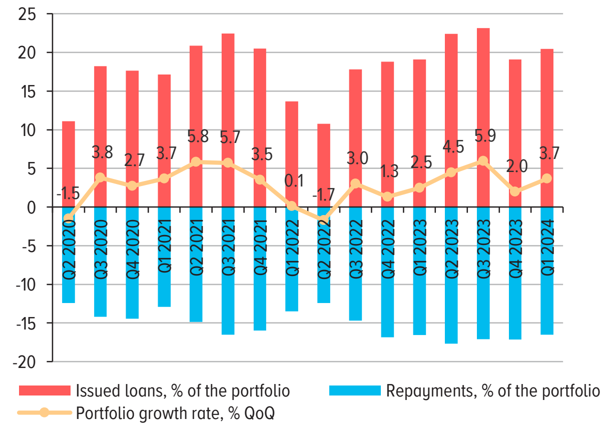
2. Dynamics of consumer lending

Amid the tightening of the Bank of Russia's monetary and macroprudential policies at the end of 2023, the expansion of lending slowed down from 5.9% in Q3 2023 to 2.0% in Q4 2023[5] (Chart 12), but accelerated again to 3.7% already in Q1 2024.

The growth of the loan portfolio was driven by credit cards that accounted for about a half of total disbursements in Q4 2023 – Q1 2024 (Chart 13). The largest part of the outstanding debt on credit cards (73%[6] as of 1 April 2024) was accounted for by cards issued before 2023.

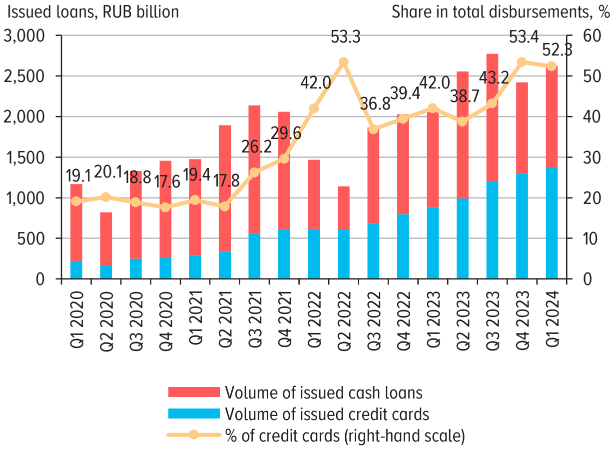
The amount of cash loans issued over Q4 2023 – Q1 2024 contracted by 24% (Chart 13), compared to the previous quarters, as a result of the toughened MPLs (Table 5) and higher interest rates (Chart 14). The average EIR on cash loans rose to 23.9% in Q4 2023 and 26.4% in Q1 2024 (+3.6 pp and +6.1 pp vs the average of Q3 2023, respectively) (Chart 16).

SHARE OF ISSUED LOANS, PORTFOLIO AMORTISATION, AND GROWTH AS % OF THE PORTFOLIO IN THE PREVIOUS REPORTING PERIOD *Chart 12*
(%)



Sources: Reporting Forms 0409115 and 0409704.

VOLUME OF ISSUED UNSECURED CONSUMER LOANS *Chart 13*

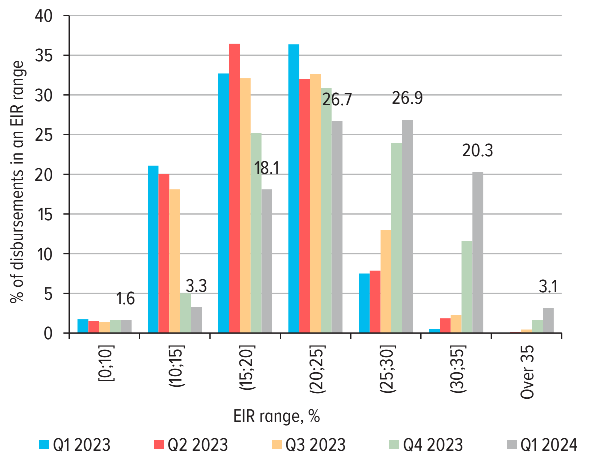


Note. Outstanding debt on loans issued over the period is given as of the end of the reporting quarter.
Source: Reporting Form 0409704.

[5] According to Reporting Form 0409115. Adjusted for securitisation in December 2023.

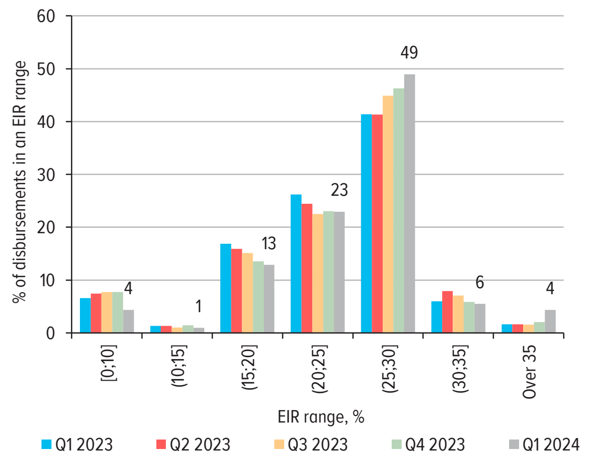
[6] According to CHBs' consolidated data.

ISSUED CASH LOANS, BROKEN DOWN BY EIR *Chart 14*
(%)



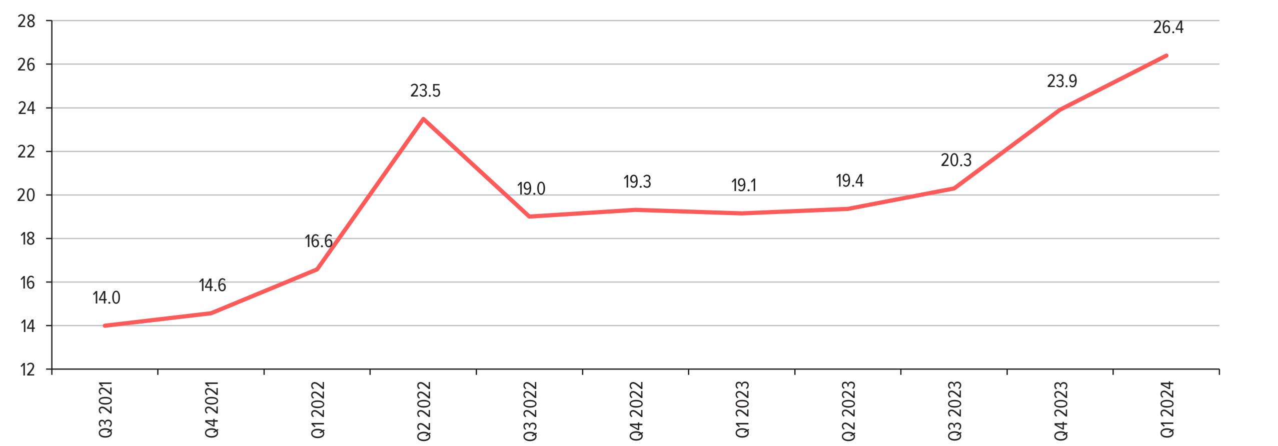
Source: Reporting Form 0409704.

ISSUED CREDIT CARDS, BROKEN DOWN BY EIR *Chart 15*
(%)



Source: Reporting Form 0409704.

AVERAGE EIR ON ISSUED CASH LOANS *Chart 16*
(%)



Source: Reporting Form 0409126.

The increase in interest rates was caused by the tightening of the Bank of Russia's monetary policy, changes in the EIR calculation rules implying that, from 21 January 2024, the EIR should include all fees influencing the loan agreement terms, and the suspension[7] of the limit on the EIR from August 2023. The suspension of this limit enabled banks to issue loans to riskier borrowers whose loan applications had previously been rejected more frequently. To ensure compliance with the MPLs, banks started to issue smaller loans to borrowers: the average cash loan decreased by 20% from RUB 173,000 in Q3 2023 to RUB 138,000 in Q4 2023.[8]

[7] See footnote 4 on page 23.

[8] According to CHBs' consolidated data.

Box 4. Situation and the Bank of Russia's measures in car lending

From 2023, banks started to actively issue loans for both new and used cars. As of 1 April 2024, the outstanding debt soared by 53% YoY (Chart 17). Over 2023, the average car loan increased by 16% from RUB 1.2 million to RUB 1.4 million, which is comparable with the rise[1] in car prices: over the year, prices for domestic and foreign cars went up by 24% and 11%, respectively. Despite the high growth rates in car lending, the outstanding debt remains relatively small, specifically RUB 1.9 trillion as of 1 April 2024, accounting for approximately 5% of the banking sector's total retail loan portfolio.

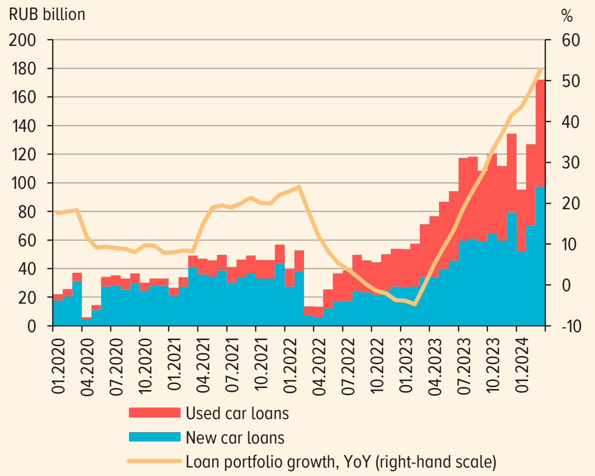
However, the acceleration of the growth in car lending was accompanied by the expansion of the proportion of loans issued to borrowers with high DSTI. In 2020, loans issued to borrowers with DSTI above 50% accounted for about 30% of the portfolio, while in Q1 2024, this percentage surged to 61%, which is notably higher than 34% in unsecured consumer lending. This involves risks to both banks and borrowers. Moreover, despite a low percentage of non-performing loans overdue for more than 90 days (NPL 90+), namely 3% as of 1 April 2024, the quality of servicing of newly issued loans was worsening: the proportion of loans that became 30-day delinquent three months after their disbursement accounted for 0.5% of the loans issued in January 2024 compared to 0.1% of the loans issued in July 2023. This rise might be because more financially sound borrowers were unwilling to raise loans at higher interest rates (the average EIR on issued loans was up from 15.5% in Q3 2023 to 21% in Q1 2024).

In order to improve banks' stability amid the surge in car lending, the Bank of Russia decided to introduce risk-weight add-ons for car loans from 1 July 2024. The size of the risk-weight add-ons depends on DSTI and corresponds to that for consumer loans with an EIR from 15% to 20%. As a result of the add-ons, by the end of 2024, banks will be able to form a capital buffer of nearly 3% of the car loan portfolio, unless they change the structure of disbursements.

RISK-WEIGHT ADD-ONS FOR CAR LOANS DEPENDING ON DSTI FROM 1 JULY 2024 *Table 3*

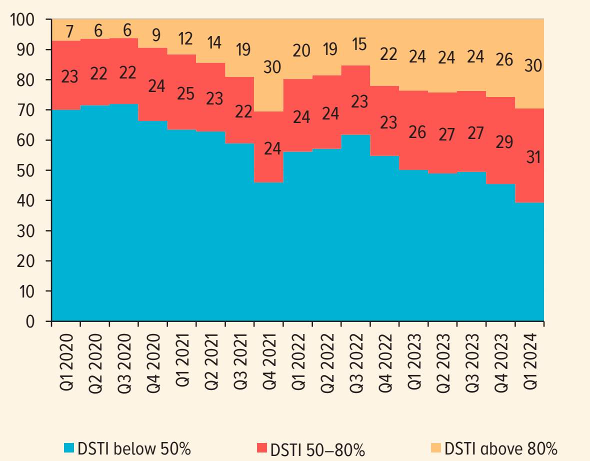
DSTI, %						
(0;30]	(30;40]	(40;50]	(50;60]	(60;70]	(70;80]	80+
no add-on	no add-on	no add-on	0.7	1.1	1.5	2.0

ISSUANCE OF CAR LOANS AND CAR LOAN PORTFOLIO GROWTH *Chart 17*



Sources: Reporting Forms 0409115 and 0409704.

ISSUED CAR LOANS, BROKEN DOWN BY DSTI *Chart 18*



Sources: Reporting Forms 0409115 and 0409704.

[1] According to Rosstat.

3. Quality of unsecured consumer loan servicing

The percentage of NPL[9] in the unsecured consumer loan portfolio remained stable, specifically 7.7% as of 1 April 2024. The quality of debt servicing is supported by the rise in households' incomes, among other things.

The quality of the unsecured loan portfolio was changing diversely across the portfolio segments. The leading indicators suggest a decrease in the quality of servicing of cash loans disbursed after 1 October 2023. Among them, the proportion of loans that became 30-day delinquent after the first three months on book (NPL 30+ after 3 MOB) edged up from 0.4% in July 2023 to 1.2% in January 2024. The loan servicing quality was worsening primarily because banks were expanding lending at higher interest rates (Chart 14), which entailed a decline in the demand for credit from more financially sound borrowers. Loans at high interest rates are more frequently raised by riskier borrowers, who are characterised by lower demand elasticity to interest rates.

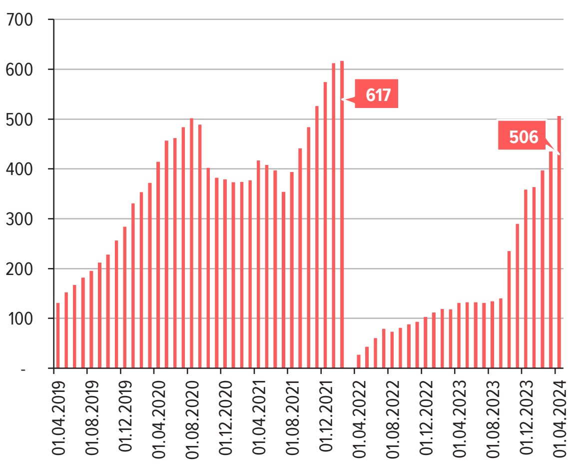
In contrast to cash loans, the debt servicing quality in the credit card segment remains at the level of early 2023: debt overdue for more than 30 days after three months since the date of money withdrawal from credit cards equals 1.5–2%. However, this percentage is higher compared to cash loans. The level of risk in the card segment remains the same because credit cards are predominantly used by clients who received them before 2023 (cards issued before 2023 account for 73% of the debt).

Considering that banks are accumulating riskier loans in their portfolios, in order to enhance the banking sector's resilience in the stress scenario, from 1 July 2024, the Bank of Russia will raise the risk-weight add-ons for unsecured consumer loans at an EIR from 25% to 40%.

4. Accumulation of the macroprudential capital buffer

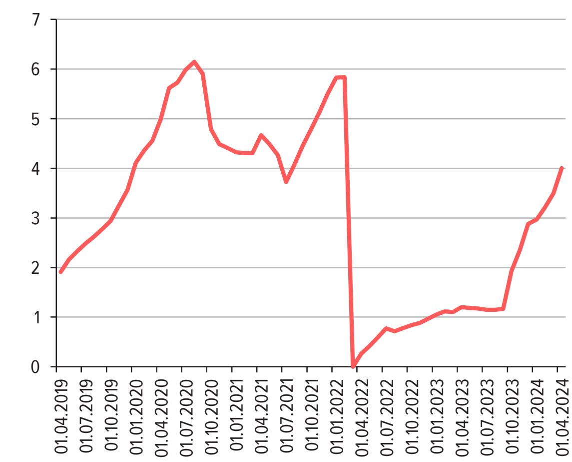
As a result of the increase from 1 September 2023 in the macroprudential capital requirements for unsecured consumer loans, the buffer accumulated by banks approximated RUB 500 billion as of 1 April 2024 (Chart 19), or 4% of the consumer loan portfolio net of loan loss provisions (Chart 20). The capital buffer is expected to reach 7% of the portfolio by the end of 2024.

MACROPRUDENTIAL CAPITAL BUFFER FOR UNSECURED LOANS* *Chart 19*
(RUB BILLION)



** Only ruble loans.*
Source: Reporting Form 0409135, Section 8.

MACROPRUDENTIAL CAPITAL BUFFER FOR UNSECURED LOANS, % OF THE PORTFOLIO* *Chart 20*



** Net of loan loss provisions.*
Sources: Reporting Form 0409135, Section 8, and Reporting Form 0409115.

[9] Loans that are more than 90 days past due.

5. Lending standards and MPLs tightening

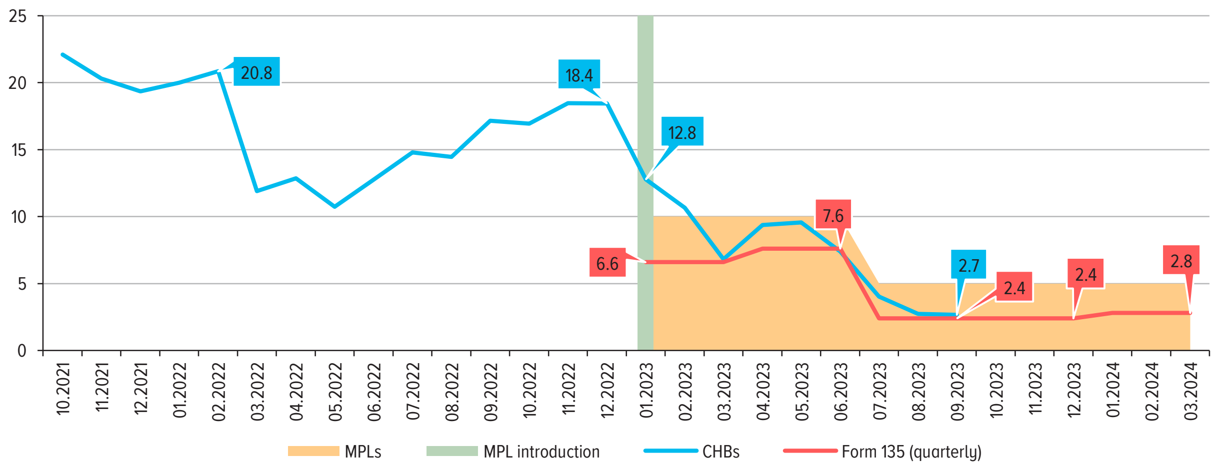
The MPLs helped further improve the standards in unsecured consumer lending: after the introduction of the MPLs, the proportion of loans issued to borrowers with DSTI above 80% declined from 36% in Q4 2022 to 13% in Q1 2024. Credit card funds provided to borrowers whose DSTI exceeded 80% accounted for 22% in Q1 2024, which is higher than the threshold provided for by the MPLs due to their time-lagged effect[10] on credit cards. The proportion of cash loans issued to borrowers with DSTI above 80% dropped to 4%.

OUTSTANDING DEBT AS OF THE END OF THE QUARTER ON CASH LOANS AND CREDIT CARDS ISSUED OVER THE REPORTING QUARTER, BREAKDOWN BY DSTI *Table 4*

Segment	DSTI range, %	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023	Q1 2024
Cash loans	(50;80]	30%	31%	33%	33%	31%	42%	40%	42%	27%	21%
	[80+)	36%	35%	25%	32%	36%	21%	22%	17%	4%	4%
Credit cards	(50;80]	24%	23%	23%	23%	21%	22%	24%	25%	25%	21%
	[80+)	31%	34%	32%	34%	38%	37%	33%	31%	26%	22%

Sources: Reporting Forms 0409704 and 0409135.

SHARE OF CASH LOANS WITH MATURITY OVER 5 YEARS *Chart 21*
(%)



Sources: CHBs' data, Reporting Form 0409135.

MPLs ON UNSECURED CONSUMER LOANS SET IN 2023–2024 *Table 5*

MPLs, %		Q1 2023	Q2 2023	Q3 2023	Q4 2023	Q1–Q2* 2024
Banks (except banks with a basic licence)	DSTI 50–80%	–	–	–	30% ↓ (20% % for CCs**) ↓	25% ↓ (10% % for CCs**) ↓
	DSTI above 80%	25%	25%	20% ↓	5% ↓	5%
	For over five years	10%	10%	5% ↓	5%	5%
MFOs	DSTI 50–80%	–	–	–	30% ↓ (20% % for CCs**) ↓	25% ↓ (15% % for CCs**) ↓
	DSTI above 80%	35%	35%	30% ↓	15% ↓	15%
	For over five years	–	–	–	–	–

** Refer to the Bank of Russia's press releases dated 24 November 2023 and 19 February 2024.*
*** Consumer loans (microloans) with a credit limit.*

[10] The MPLs on credit cards restrict the share of limits newly opened or increased by lenders rather than the percentage of actual disbursements to borrowers with high DSTI as decisions on utilising the limit is made by borrowers. The largest part of the debt is accounted for by credit cards issued before the MPLs were tightened or even enacted.

The share of long-term loans issued by banks is within the thresholds set by the MPLs and stayed nearly unchanged over Q4 2023–Q1 2024. Cash loans for over five years accounted for 2.8% of total disbursements in Q1 2024 compared to 18.2% before the introduction of the MPLs (Chart 21).

The absolute majority of banks were compliant with the MPLs, whereas the number of non-compliant banks was gradually decreasing. Total debt on loans breaching the MPLs was relatively small, accounting for less than 0.1% in Q1 2024.

6. Consumer microfinance

In Q1 2024, the growth of the consumer microloan portfolio sped up to 7.2% (+3.00 pp over the quarter). The acceleration might be evidence that market participants are adapting to the MPLs introduced in 2023. From the beginning of 2024, the MPLs require the calculation of DSTI for microloans smaller than RUB 10,000 as well.

As a result of the consistent toughening of the MPLs, the proportion of microloans issued by microfinance organisations (MFOs) to borrowers with DSTI above 80% declined from 40% in Q4 2022 to 15% in Q1 2024.[11] This reduction was accompanied by an increase in disbursements in the segments of DSTI below 50%.

So far, there is no considerable flow of borrowers from the banking sector to MFOs: as of 1 April 2024, the MFO market accounted for 2.7% of the portfolio of unsecured consumer loans. Symmetrical toughening of the MPLs for MFOs will help reduce the risks of regulatory arbitrage.

3.3. Imbalances in the residential real estate market and project finance risks

In early 2024, mortgage lending continued to expand, but at a more balanced pace. In order to avoid an uncontrollable increase in households' debt burden and encourage banks to assess risks more conservatively, the Bank of Russia was gradually tightening the requirements for loans issued to borrowers with high DSTI. The Bank of Russia's measures helped reduce the share of loans issued to borrowers with high DSTI (above 80%), specifically from 42% to 27% of total loans for new housing (-15 pp QoQ) and from 48% to 39% of total loans for existing housing (-9 pp QoQ).

However, the expansion of the mortgage portfolio was supported by the government subsidised programmes (60% and nearly 70% of total mortgage loans in 2023 and Q1 2024, respectively), which continued to fuel a faster rise in prices for new housing. Higher interest rates moderated market-based mortgage lending and the increase in prices for existing housing. Hence, the gap between new and existing housing prices in Q1 2024 remained wide, specifically 55% according to Rosstat and 45% as reported by Domclick. The difference in prices involves the risk that mortgage borrowers or banks will be unable to sell the real estate without losses. To reduce this risk, the Bank of Russia discouraged banks from issuing mortgages with a small down payment of less than 20%. These measures, along with the tightening of the requirements under the subsidised programmes by the Russian Government, helped reduce the proportion of mortgages with a low down payment from 52% in Q4 2022 to 17% in Q1 2024, specifically in the new housing market – from 69% to 2%.

In H2 2024, the situation in mortgage lending and the housing market will primarily depend on the terms of the subsidised mortgage lending programmes and changes in the key rate. Most construction projects will remain resilient in the scenario of a slower rise in sales and adjustment of housing prices. More targeted subsidised programmes (a decrease in their scale) will contribute to a gradual reduction in the gap between new and existing housing prices.

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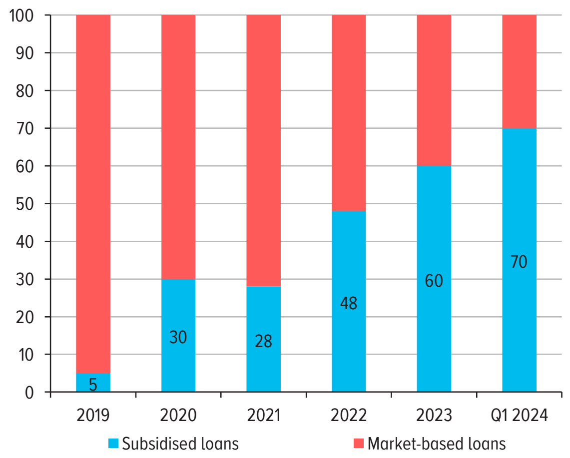
[11] The figures for DSTI were calculated based on comparable samples of the 48 largest MFOs accounting for 74% of the microfinance market.

1. Dynamics of mortgage lending

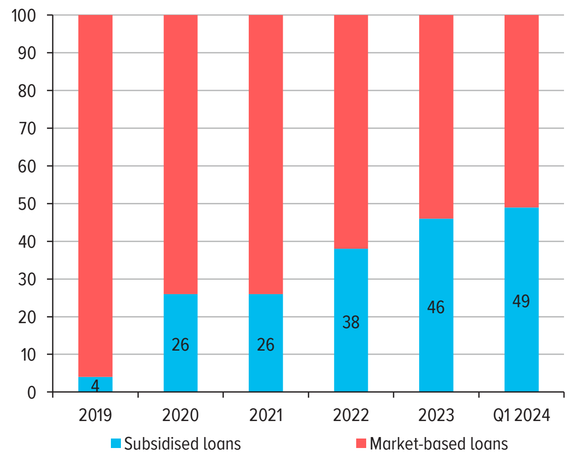
Amid high demand for new housing in H2 2023, the growth rate of the mortgage portfolio hit a record high of 34.5% YoY, with the portfolio reaching RUB 18.2 trillion as of 1 January 2024. However, the tightening of the terms of subsidised mortgage lending[12] and the decline in the demand for loans at market-based interest rates slowed down the expansion of the mortgage portfolio. In Q1 2024, its growth rate equalled 2.6%. Amid high market rates, the government subsidised programmes accounted for nearly 70% of all mortgage loans issued in Q1 2024, or about a half in terms of the number of mortgages (Charts 22 and 23).

STRUCTURE OF ISSUED SUBSIDISED AND MARKET-BASED LOANS IN MONEY TERMS *Chart 22*
(%)



Source: DOM.RF's analytics.

STRUCTURE OF ISSUED SUBSIDISED AND MARKET-BASED LOANS IN QUANTITATIVE TERMS *Chart 23*
(%)



Source: DOM.RF's analytics.

2. Mortgage lending risks

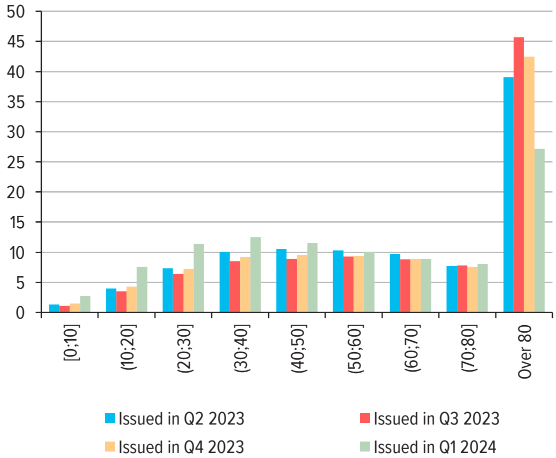
Lending quality and standards

The quality of mortgage servicing remains good so far. As of 1 April 2024, the portfolio of NPL 90+ amounted to RUB 74 billion, which is close to RUB 73 billion in 2023. As the loan portfolio soared, the share of non-performing loans decreased to 0.5% in 2023. Households maintain the payment discipline primarily owing to rising incomes: according to Rosstat, over 2023, per capita nominal income and nominal wages were up by 11% and 13%, respectively.

However, the expansion in mortgage lending over 2023 was largely driven by loans issued to over-indebted borrowers: by 1 January 2024, the proportion of loans issued to borrowers with high DSTI (over 80%) increased from 33.6% to 42.5% of total new housing loans and from 39.4% to 48.1% of total existing housing loans. As the lending standards worsened amid the surge in the mortgage portfolio, it was necessary to tighten the macroprudential regulation. The Bank of Russia raised the macroprudential requirements in mortgage lending thrice. Pursuant to the latest decision, from 1 March 2024, their values for borrowers with DSTI above 80% reached a prohibitive level. In these conditions, the macroprudential capital buffer for the mortgage portfolio was steadily growing to reach RUB 216 billion, or 1.2% of the portfolio as of 1 April 2024. The tightening of the macroprudential regulation by the Bank of Russia helped reduce the risks of households' over-indebtedness. In particular, as of 1 April 2024, the share of loans issued to borrowers with DSTI

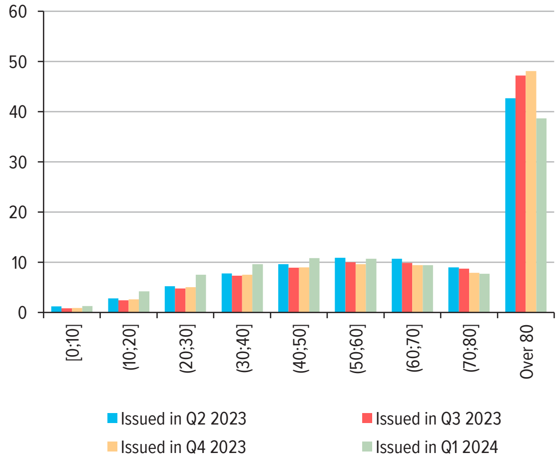
[12] For borrowers it meant a reduction in the maximum loan and a higher percentage of the minimum down payment for a subsidised mortgage, and for banks it was a decrease in the parameter used to calculate the compensation due to banks for the profits lost because of issuing subsidised loans under all programmes.

BREAKDOWN OF MORTGAGE LOANS BY DSTI (EQUITY PARTICIPATION AGREEMENT) *Chart 24*
(%)



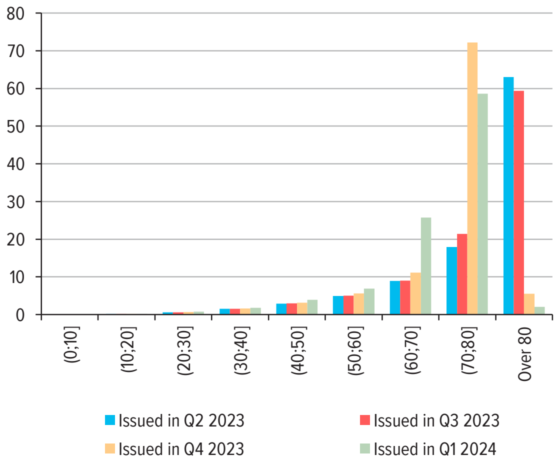
Source: Reporting Form 0409704.

BREAKDOWN OF MORTGAGE LOANS BY DSTI (NON-EQUITY PARTICIPATION AGREEMENT) *Chart 25*
(%)



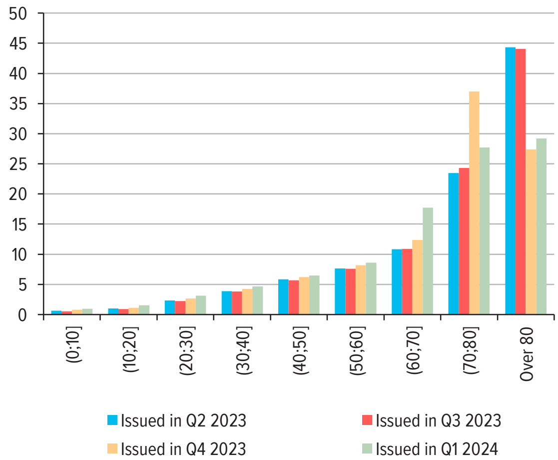
Source: Reporting Form 0409704.

BREAKDOWN OF MORTGAGE LOANS BY LTV (EQUITY PARTICIPATION AGREEMENT) *Chart 26*
(%)



Source: Reporting Form 0409704.

BREAKDOWN OF MORTGAGE LOANS BY LTV (NON-EQUITY PARTICIPATION AGREEMENT) *Chart 27*
(%)



Source: Reporting Form 0409704.

above 80% decreased by 15.2 pp QoQ to 27.2% for newly issued mortgages in the new housing segment and by 9.4% QoQ to 38.7% in the existing housing segment.

The increases in the macroprudential add-ons by the Bank of Russia and the down payment under the subsidised programmes by the Russian Government resulted in the redistribution of issued loans in Q1 2024 from the LTV range of 80–90% to 60–70%.

The Bank of Russia monitors the accuracy of banks' collateral valuations for mortgages. Loans issued under the programmes of subsidised mortgages from developers[13] make up a large share in the generations of mortgages of 2022–early 2023. As a result of the persistent overpricing of housing in these transactions, the actual LTV ratio as of the date of the agreement often exceeded 100%. The Bank of Russia assesses the accuracy of the LTV calculation as part of its regular inspections. According to the findings of the latest inspections, the average current value of collateral is close to the market average due to high nominal growth rates of real estate prices in 2022–2023. As to the

[13] In 2022, developers were actively offering subsidised lending programmes at extremely low interest rates of up to 0.01%, while raising housing prices by 20–25% (refer to the consultation paper Developer Subsidised Mortgage Programmes).

part of loans where the LTV ratios were understated, banks will be advised to adjust the collateral valuations.

In January 2024, a number of the largest mortgage banks introduced fees for housing developers in the case of apartment purchases under the government subsidised mortgage lending programmes. They made this decision following the reduction in the compensation payable from the budget system to banks from the level of 'the key rate + 2.0%' to the level of 'the key rate + 1.5%'. As a result of the fees reaching 5–8% of the apartment price, there was a considerable redistribution over January–February 2024 in new subsidised mortgages towards banks not charging the fees. As the banks that had set the fees lost a share of the market, by the beginning of March 2024, most credit institutions decided to cancel them.

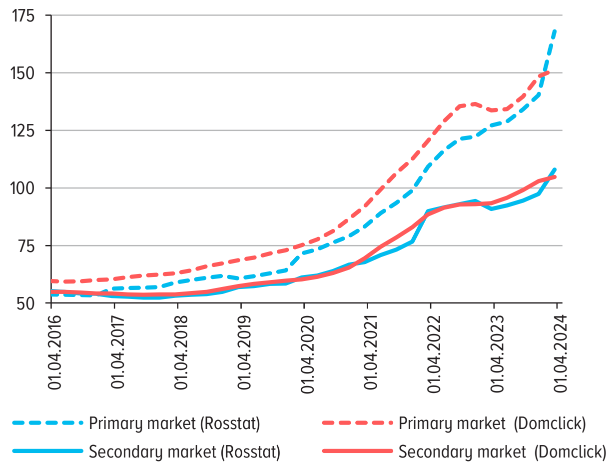
Furthermore, in H2 2023 amid a gradual increase in the balances in escrow accounts and the reduction in the compensation for subsidised mortgages, the Bank of Russia detected new practices in the housing construction and mortgage lending market aimed at circumventing the existing system requiring the depositing of shared construction participants' funds in escrow accounts. Within these schemes, instead of escrow accounts, the funds are transferred to letters of credit that are beyond the framework of the deposit insurance system. This involves risks to buyers in case a borrower becomes bankrupt or a credit institution's licence is revoked. Considering such practices unacceptable, the Bank of Russia took a set of measures to prevent their wider usage.

Overheating in the new housing market and housing affordability

Although the demand for new housing stabilised in Q1 2024, the imbalance in the residential real estate market associated with the difference in new and existing housing prices persists, which is evidenced by both Rosstat and Domclick. The gap between new and existing housing prices in Russia in Q1 2024 reached 55% according to Rosstat (vs 44% in Q4 2023) and 45% as reported by Domclick (vs 43% in Q4 2023). The reasons for the persistent price gap are as follows: developers include the bank fees in new housing prices, while the affordability of existing housing has declined amid the rise in market rates to 17%, shifting the demand to the new housing market where buyers have access to subsidised mortgage lending.

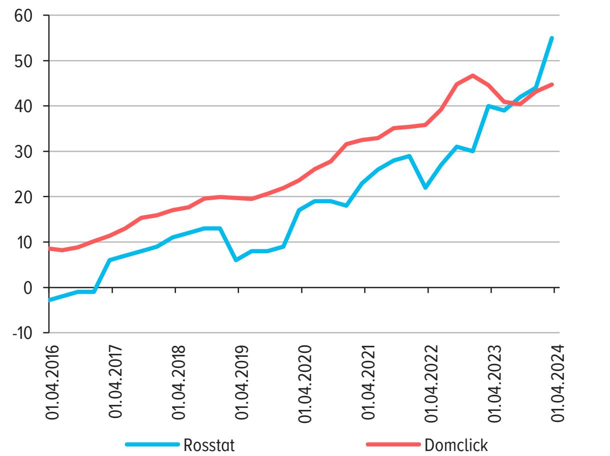
Furthermore, housing prices have deviated from their long-term trends, which is also evidence of price overheating in the new housing segment. As of Q1 2024, the overheating index in the new housing market reached 15%, in contrast to 1% for existing housing.

NOMINAL HOUSING PRICES *Chart 28a*
(RUB THOUSAND PER SQ M)



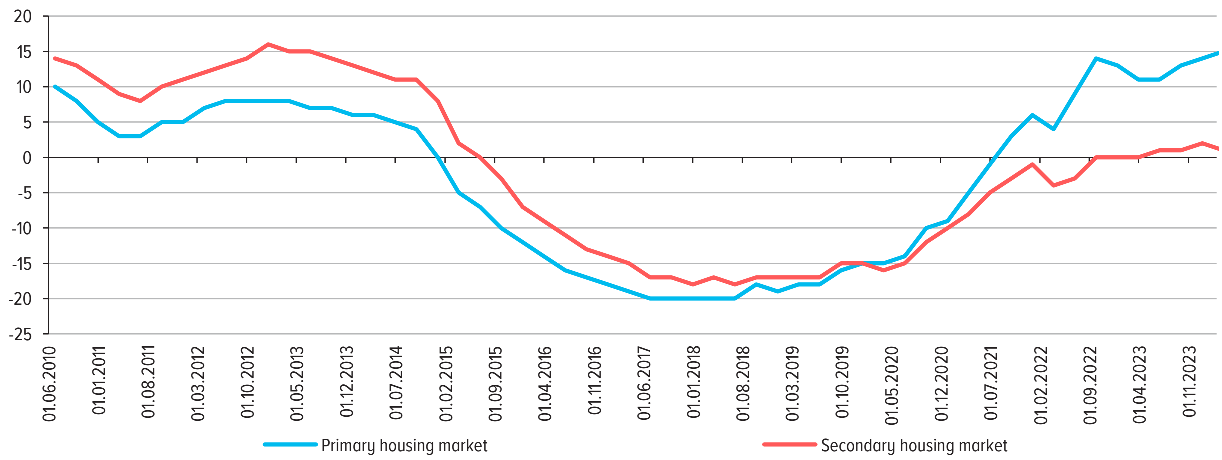
Sources: Rosstat, Domclick, Bank of Russia calculations.

GAP BETWEEN NOMINAL HOUSING PRICES *Chart 28b*
(%)



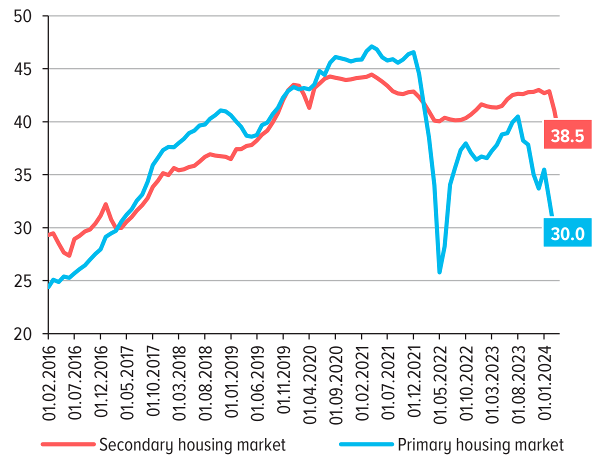
Sources: Rosstat, Domclick, Bank of Russia calculations.

CYCLICAL COMPONENT OF THE REAL HOUSING PRICE INDEX BASED ON THE HP FILTER (=400,000) *Chart 29*
(%)



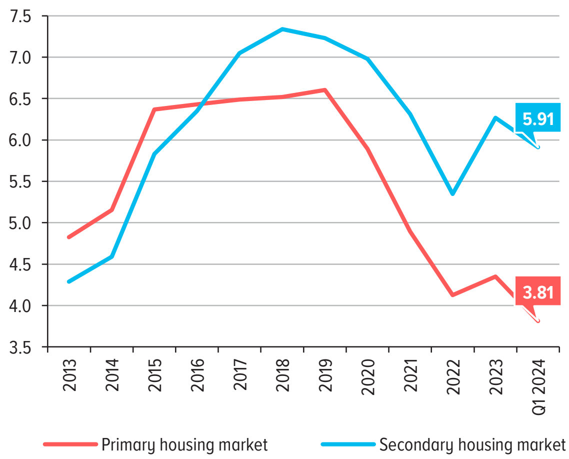
Sources: Rosstat, Bank of Russia calculations.

HOUSING AFFORDABILITY INDEX FOR MORTGAGE *Chart 30*
(SQ M)



Sources: Reporting Form 0409316 and Rosstat.

LIVING SPACE (DOWN PAYMENT) THAT CAN BE FINANCED FROM DEPOSITS *Chart 31*
(SQ M)



Sources: Reporting Form 0409316 and Rosstat.

Nevertheless, to be able to raise a mortgage, a borrower needs to have a sufficient amount of funds to make the down payment. According to the requirements of the Subsidised Mortgage programme, the down payment shall be at least 30% of the loan. Thus, when an area of 38.5 square metres is bought on credit, another 16.5 square metres shall be financed from the borrower's own funds. However, individuals' ability to make the down payment from their own funds deposited with banks[14] is actually decreasing. In particular, in 2017, a borrower whose overall balance in all deposits averaged RUB 343,000 was able to make the down payment for 6.5 square metres in a new house, hereas in Q1 2024, this figure declined to 3.8 square metres (with the overall balance in all deposits averaging RUB 639,000).

In H2 2024, the situation in the housing market will depend on the terms of the government subsidised programmes and the key rate path. The termination of the large-scale Subsidised Mortgage programme enabling a wide range of buyers (including investors) to purchase housing will help ensure a more balanced growth rate in mortgage lending and stabilise new housing prices.

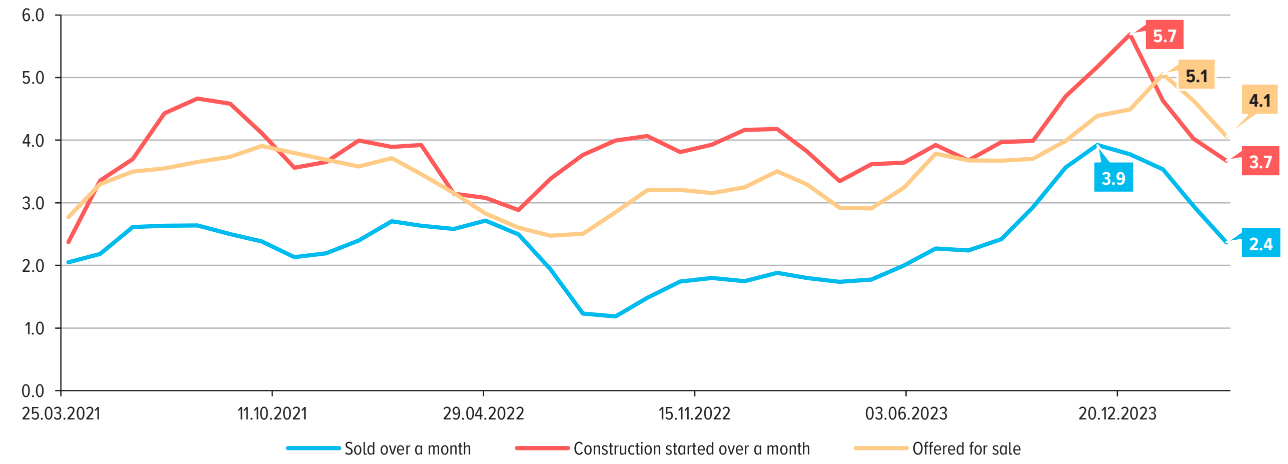
[14] Deposits, current accounts, and demand accounts.

3. Project finance risks

In Q4 2023, demand shifted to the new housing market (Chart 32). In Q2 2023, the monthly sales of housing under construction did not exceed 2.5 million square metres, whereas in Q4 2023, they soared to a record high of 3.9 million square metres. Amid the surge in the sales in December 2023, the new construction area[15] expanded to 5.7 million square metres, while the new supply of housing[16] increased to 5.1 million square metres in January 2024.

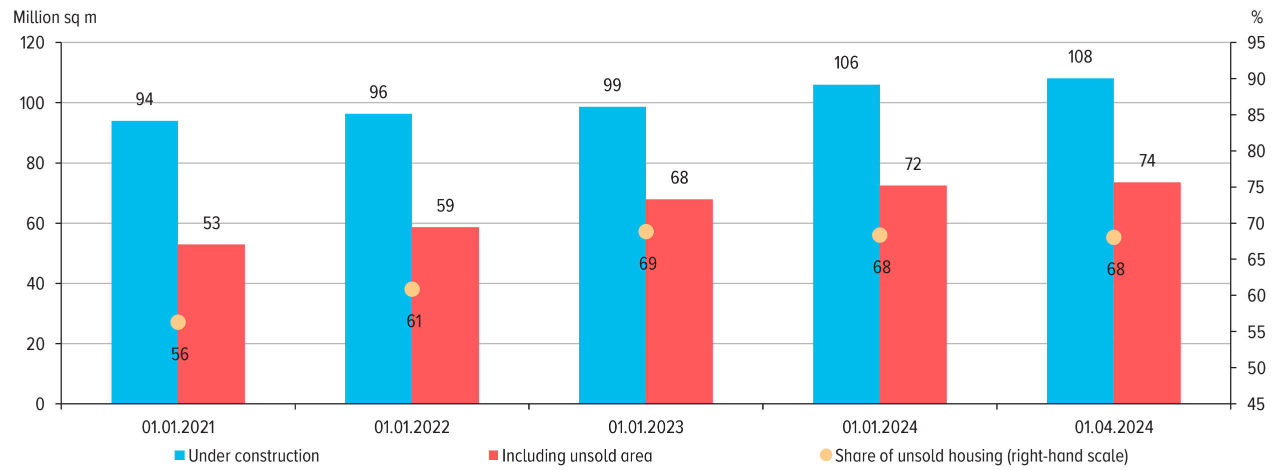
Given the contraction of the sales in Q1 2024, developers reduced the area of new construction projects to the level of mid-2023. As a result, the new supply began to exceed the new construction area, which lowers potential risks of oversupply in the market in H2 2024. The percentage of unsold new housing remains at the level typical of recent years, namely 68–69% of the total area of projects under construction.

HOUSING UNDER CONSTRUCTION, NEW PROJECTS FOR SALE, AND ACTUAL SALES OF NEW HOUSING IN RUSSIA, THREE-MONTH MOVING AVERAGE *Chart 32*
(MILLION SQ M, THREE-MONTH MOVING AVERAGE)



Sources: UHCIS, Bank of Russia calculations.

CONSTRUCTION PROJECTS AND UNSOLD HOUSING IN RUSSIA *Chart 33*



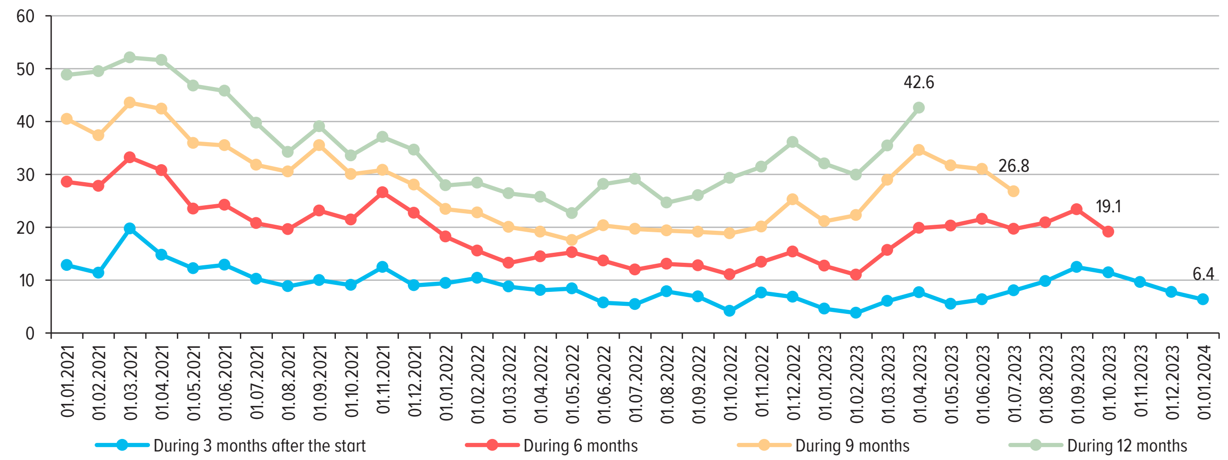
Sources: UHCIS, Bank of Russia calculations.

[15] According to JSC DOM.RF, a project is classified as a house under construction if it is not troubled and the information about its construction has been entered by disclosing the project declarations in developers' online accounts in the UHCIS.

[16] According to JSC DOM.RF, a project is classified as a house available for sale (new supply) after the developer has signed the first two SCP agreements.

NEW HOUSING SALES, BY THE PERIOD AFTER THE START OF CONSTRUCTION
(%)

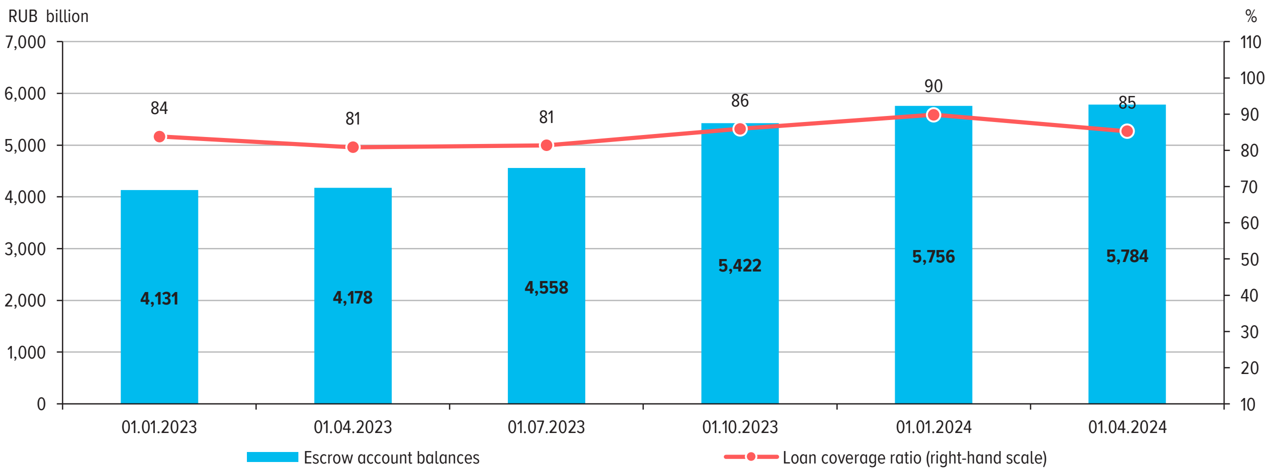
Chart 34



Sources: UHCIS, Bank of Russia calculations.

COVERAGE RATIO FOR DEVELOPERS' LOANS WITH FUNDS ON ESCROW ACCOUNTS AND ESCROW ACCOUNT BALANCES

Chart 35



Sources: Reporting Form 0409115, the Bank of Russia's survey.

In 2023, the period of the sale of unsold new housing shortened to 2.1 years. The vintage data by the period after the start of construction demonstrate increases in the sales (Chart 34). Thus, the percentage of new housing sold over the first nine months after the start of construction rose to 34.6% while failing to reach the level of 43% recorded in Q1 2021. In early 2024, amid the decline in the sales, the proportions of housing sold within the first three and nine months after the start of construction decreased to 6.4% and 26.8%, respectively. People's demand for new housing might be expected to drop in H2 2024 as a result of the tightening of the subsidised mortgage lending terms from 1 July 2024.

Following the increase in the demand for housing, the balances in escrow accounts were up by 39% in Q4 2023, compared to the beginning of the year. Concurrently, the growth rate of funds in escrow accounts exceeded that of the project finance debt, which entailed a rise in the coverage ratio to 90%. In early 2024, the amount of funds in escrow accounts remained nearly the same. However, as developers' debt to banks increased, the coverage ratio declined to 85%.

The large balances in escrow accounts and the high percentage of sold new housing strengthen the construction sector's resilience to a potential contraction of households' demand in H2 2024.

This scenario is possible if the terms of the government subsidised lending programmes alter significantly and monetary policy remains tight. To assess the consequences of this scenario, at the end of 2023, the Bank of Russia surveyed the largest banks accounting for over 80% of the loans issued to developers. Based on the distribution of the LLCR,[17] banks estimated the resilience of the project finance portfolio to a key rate increase and a decline in sales over the entire period of the implementation of housing projects. In the scenario of a 10% decrease in earnings from the sales, the majority of housing construction projects remain financially resilient.

3.4. Corporate lending and concentration risk

From November 2023, amid the persistently high key rate, loans restructurings were primarily aimed at changing the maturity date and not because of decline in borrowers' creditworthiness. The proportion of NPL was declining to equal 4% as of the end of Q1 2024.

In Q4 2023–Q1 2024, the dedollarisation of corporate debt slowed down: as of 1 April 2024, the share of foreign currency loans equalled 17%, declining[18] by about 2 pp in annualised terms. In these conditions, companies continued to substitute 'toxic' currencies with friendly states' currencies.

Concentration risks rose in recent years. Moreover, Russian banks have always been characterised by high concentration as the largest domestic companies needed substantial borrowings relative to the scale of the banking sector's business. As Russian companies have been repaying their external debt since 2022, the amount of their liabilities to the Russian financial sector has been increasing and bank loans have become the main source of financing. The debt of the five largest companies[19] to Russian banks totals 56% of the banking sector's capital. The Bank of Russia plans to gradually modify the banking regulation to establish additional limits on concentration risk.

NBFIs' concentration on the five largest companies is lower, specifically 17% of NPFs' assets and open-end and exchange-traded UIFs' net asset value. However, the ratio between NBFIs' largest investee and equity is rather high as well, namely 42% among insurers and 67% among NPFs.

1. Corporate debt dynamics

Over the past year, the growth rate of non-financial companies' obligations was consistent with that of nominal GDP, with the ratio between them staying at 51%. Furthermore, the largest part of the corporate debt is concentrated in the banking sector: the share of loans issued by Russian banks increased by 17 pp[20] over the year, reaching 74% as of 1 January 2024. As of 1 April 2024, non-financial companies' debt obligations included ruble loans totalling RUB 54.4 trillion and foreign currency loans amounting to RUB 11.4 trillion (USD 123.5 billion) granted by Russian banks, as well as issued debt securities worth RUB 10.6 trillion, and external debt totalling RUB 12.4 trillion as of 1 January 2024.

Over the past two quarters, non-financial companies' outstanding debt surged by over RUB 4 trillion. In Q4 2023–Q1 2024, the expansion of lending was driven by large companies raising working capital loans, investment loans for projects in almost all industries,[21] and loans for merger

[17] Loan life coverage ratio – a measure of the project's ability to repay an outstanding loan using free cash flows from housing sales over the life of the loan.

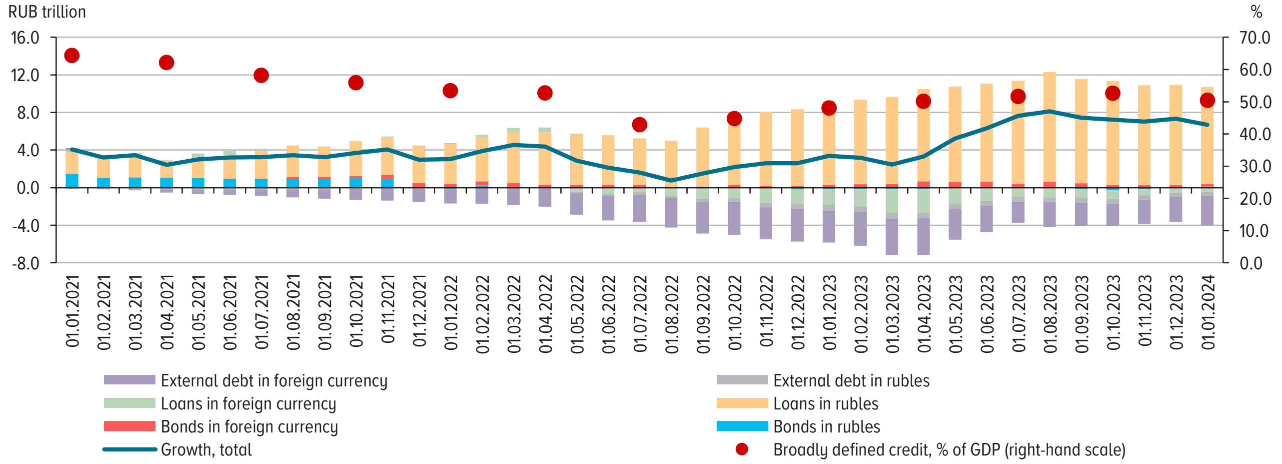
[18] Adjusted for foreign currency revaluation at the exchange rate as of 1 April 2024.

[19] The largest companies include the Russian groups of non-financial companies whose liabilities and annual revenues exceed RUB 1 trillion according to the IFRS.

[20] Adjusted for foreign currency revaluation as of 1 January 2024; not adjusted – by 12 pp.

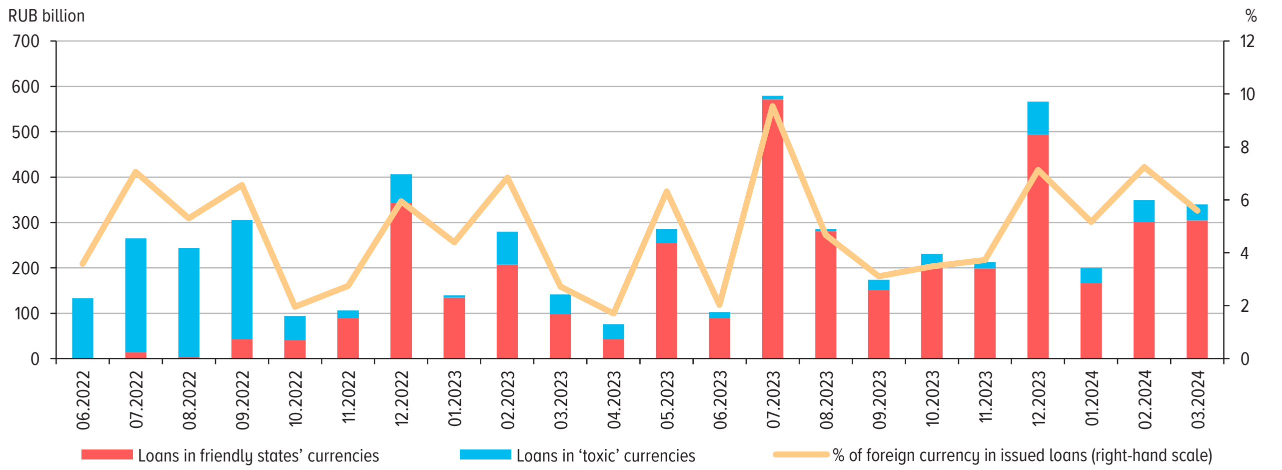
[21] The largest loans were issued to transport and transportation, oil and gas, and chemical companies.

CONTRIBUTION OF INDIVIDUAL FACTORS TO THE ANNUAL DYNAMICS OF NON-FINANCIAL COMPANIES' DEBT OBLIGATIONS (ADJUSTED FOR FOREIGN CURRENCY REVALUATION) *Chart 36*



Sources: loans and acquired claims – Reporting Form 0409101; bonds – the Bank of Russia's data (securities at par value issued in the domestic market); external debt – the Bank of Russia's statistics (the aggregate measure of the non-financial sector's and households' debt, %).

FOREIGN CURRENCY LOANS FOR OVER A MONTH ISSUED TO NON-FINANCIAL COMPANIES (NOT ADJUSTED FOR FOREIGN CURRENCY REVALUATION) *Chart 37*



Source: Reporting Form 0409303.

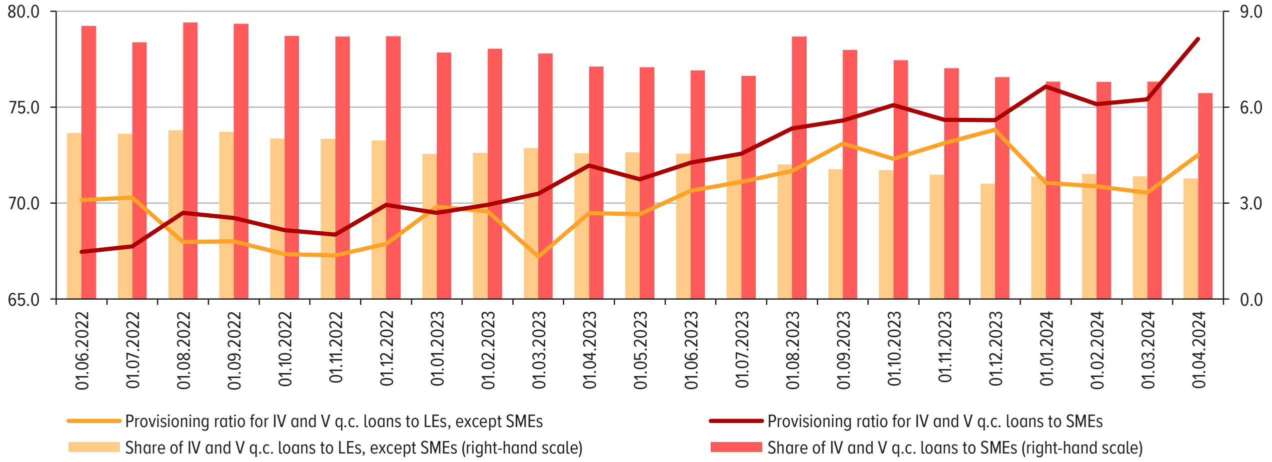
OUTSTANDING LOANS ACROSS BORROWER TYPES FROM 1 OCTOBER 2023 TO 1 APRIL 2024, ADJUSTED FOR FOREIGN CURRENCY REVALUATION AS OF 1 APRIL 2024 *Table 6*

Borrower type	**Growth, RUB trillion**
Large non-financial companies	3.1
Financial companies	1.3
SMEs	1
Developers	0.4
Non-residents	-0.1

Sources: Reporting Form 0904303, loans and acquired claims.

SHARE OF LOANS OF QUALITY CATEGORIES IV AND V AND THE PROVISIONING RATIO ACROSS BANKS, EXCEPT THE BNA *Chart 38*

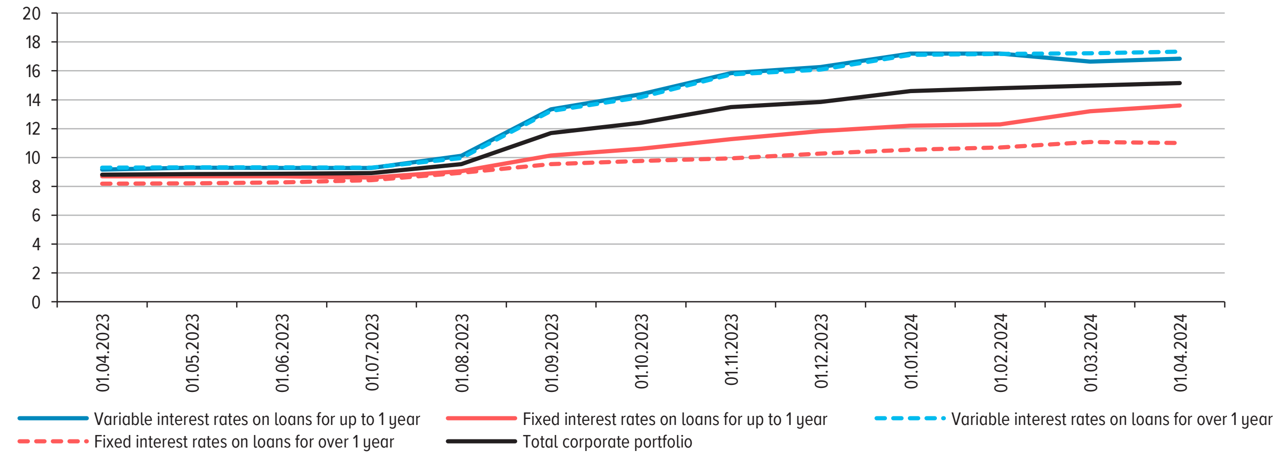
(%)



Source: Reporting Form 0409115.

WEIGHTED AVERAGE INTEREST RATE ON EXISTING LOAN PORTFOLIOS AT FIXED AND VARIABLE INTEREST RATES, BY MATURITY; EXCEPT PROJECT FINANCE *Chart 39*

(%)



Source: Reporting Form 0409303.

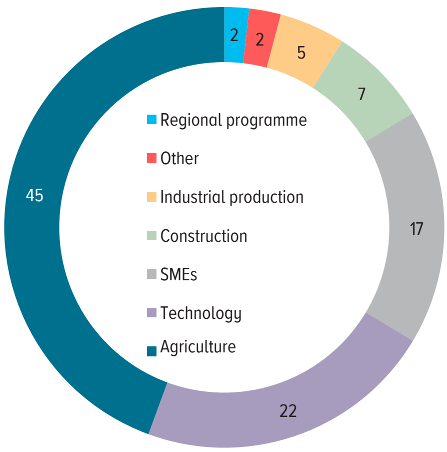
and acquisition transactions with foreign companies' assets. There was a considerable increase in the loan debt of financial companies, including, among others, leasing and factoring entities related to banking groups. This rise was observed amid fast growth in leasing and factoring. Over the previous periods, specifically from early 2022 through Q3 2023, project finance in housing construction was a key driver of the expansion of the loan portfolio. However, as the demand for housing trended upwards in H2 2023 and the funds in escrow accounts were actively used, loans to this sector were amortised in December–January.

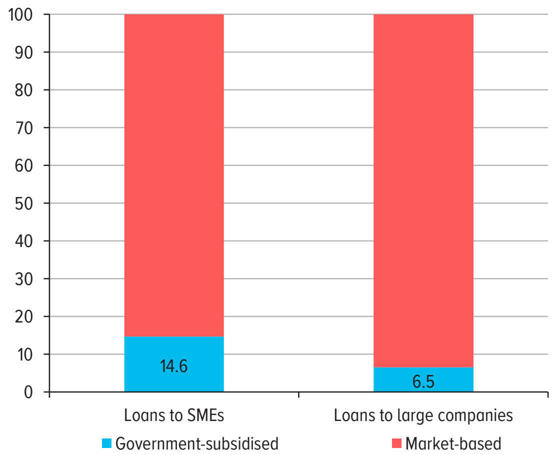
Until November 2023, the proportion of foreign currency loans in the corporate portfolio had been shrinking. However, from 1 November 2023 to 1 April 2024, it edged up by 0.5 pp[22] to 17.3%. There are almost no new loans issued in 'toxic' currencies. Their share in the loan portfolio is being gradually substituted with loans in rubles and friendly states' currencies.

As of 1 April 2024, the proportion of loans in friendly countries' currencies in the corporate portfolio was nearly 7%, whereas that of loans in 'toxic' currencies was about 10%. The former increased by 4.0 pp, while the latter declined by 6.5 pp (adjusted for revaluation as of 1 April 2024).

[22] Adjusted for foreign currency revaluation.

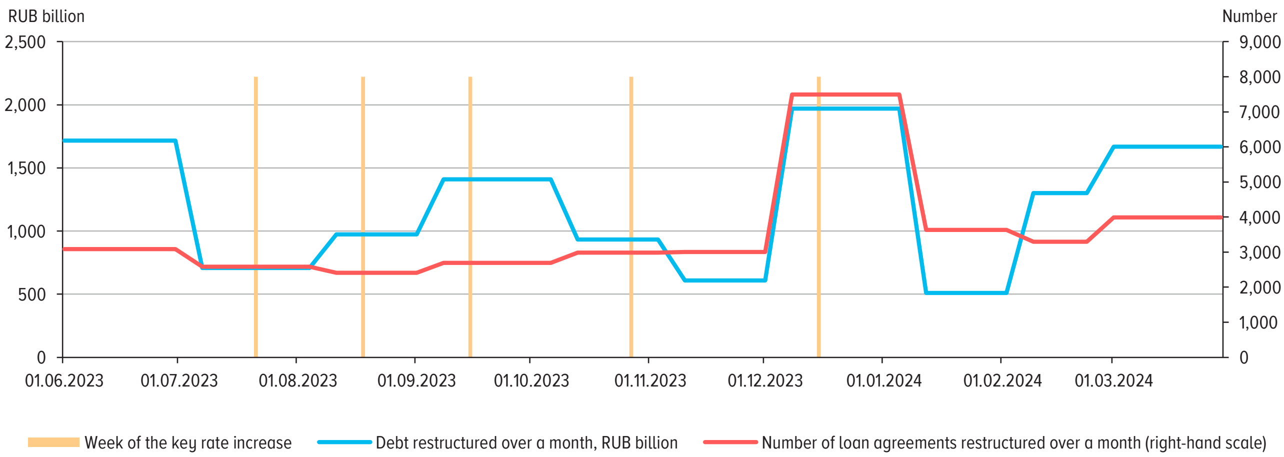
LOANS ACROSS GOVERNMENT PROGRAMME TYPES IN THE PORTFOLIO AS OF 1 JANUARY 2024 AND THE SHARE OF SMEs' AND LARGE COMPANIES' SUBSIDISED PORTFOLIOS *Chart 40*
(%)





Sources: Reporting Form 0409303, the Bank of Russia's survey.

NUMBER AND AMOUNT OF NON-FINANCIAL COMPANIES' RESTRUCTURED LOANS* *Chart 41*



** Restructured loans were calculated without adjusting for foreign currency revaluation, based on the amount of debt as of the reporting date during the period when a loan was restructured; loans restructured repeatedly were not excluded – the latest date of restructuring during a given month was taken into account for each reporting month.*
Source: Reporting Form 0409303.

Approximately 38% of foreign currency loans were issued to non-residents,[23] while loans in friendly states' currencies were raised predominantly by Russian exporters. Considerable amounts of loans in friendly countries' currencies were mostly raised by oil and gas, mining and quarrying, and chemical companies. Organisations used bond issues in friendly states' currencies to finance their operations to a much lesser extent. At the moment, it would be unreasonable to introduce macroprudential add-ons for legal entities' foreign currency obligations as the process of dedollarisation still continues overall.

2. Quality of the corporate loan portfolio

Amid high economic growth rates, the share of troubled assets has been decreasing among both SMEs (by 1 pp over the year to 6% of the portfolio as of 1 April 2024) and large borrowers (by 1 pp to 4% of the portfolio as of 1 April 2024).

The key rate increase has a time-lagged effect on fixed rate borrowers – as they repay the loans. Over the year, the average interest rate on long-term fixed rate loans was up by 2.8 pp, while the key rate

[23] Those were mostly loans to finance projects implemented jointly with friendly states.

was raised by 8.5 pp. Simultaneously, borrowers and banks are increasingly concluding variable rate agreements, assuming that interest rates will drop in the future. From 1 October 2023 to 1 April 2024, the proportion of such loans in total disbursements to corporate borrowers averaged 60%,[24] which is 7 pp more YoY. Banks normally offer variable rate loans to large stable companies that are well aware of their interest rate risks.

A part of borrowers raising loans under government subsidised programmes are not responsive to interest rate growth as it is offset by the budget system. Outstanding loans issued under such programmes[25] total RUB 5.4 trillion (nearly 7.5% of the corporate portfolio as of early 2024). Loans under these programmes are issued mostly to agricultural and hi-tech companies.

The percentage of government subsidised loans in certain industries is rather high. Specifically, this proportion in agriculture equals 55%, which is a widespread practice in other countries as well. As of 1 January 2024, approximately 15% of all loans to SMEs were subsidised, while this share in large businesses exceeded 6%.

Overall, the key rate increase has not yet entailed extensive restructuring of variable rate loans. The number of restructured loans did not exceed the average of the past few years. Moreover, most borrowers have safety cushions owing to sufficiently high profit margin in their business and remain stable despite high interest rates.

The largest loans restructured in December 2023 were those issued to oil and gas, transport, and construction companies. Small outstanding loans were restructured primarily to extend their maturity date or because of early repayments rather than due to a decline in borrowers' creditworthiness.

3. Risk of concentration of non-financial companies' obligations

The Russian banking sector has always been highly concentrated as the Russian largest companies needed substantial debt financing compared to the Russian largest banks' capabilities in terms of the size of their capital. After unfriendly states had imposed restrictions on financing to Russian companies in 2022, the latter started to raise funds in the domestic market. However, despite the reduction in external debt,[26] companies were substituting it with new loans, which entailed concentration of credit risk among the largest banks. Furthermore, companies prefer to cooperate with a small number of banks under bilateral agreements without scrutinising any other sources of debt funding, e.g., syndicated lending or bonds, which would ensure a wider distribution of risk. The ratio of the largest companies'[27] outstanding debt[28] to the banking sector's capital had been quickly growing from Q4 2022 to reach 56% as of 1 April 2024. Over the past 18 months, banks' capital was expanding as well. Therefore, the increase in the ratio resulted exactly from active lending to large businesses. The ratio measures the hypothetical threshold of the banking sector's losses in case all the five largest companies fail to fulfil their obligations to banks and all their debts are written off. The default of at least one of these companies and the loss of all invested funds are surely a highly unlikely event. Nonetheless, the best risk management practices assess concentration risk using indicators that measure banks' risk exposure without taking into account the probability of a borrower's default.[29]

The Bank of Russia monitors the banking sector's concentration risk and, as the situation has notably worsened, plans to introduce additional restrictions. In particular, in 2024, the Bank of Russia

[24] For loans and acquired claims in rubles on non-financial companies, except loans issued by VEB.RF.

[25] Over 70 programmes were reviewed.

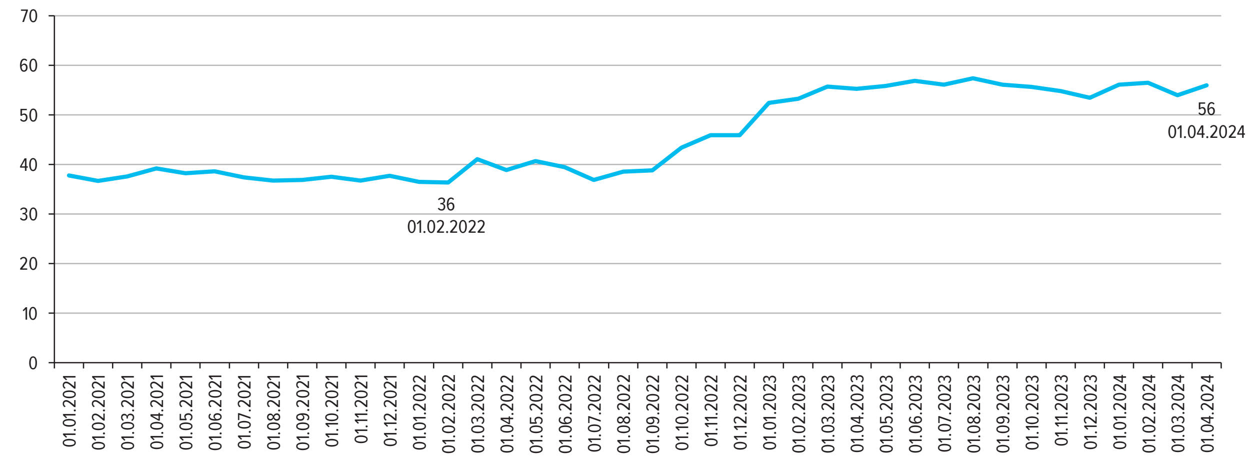
[26] From 1 January 2022 to 1 January 2024, the outstanding debt in rubles decreased by RUB 1.0 trillion and that in US dollars – by RUB 91.4 billion.

[27] The largest companies include the Russian groups of non-financial companies whose liabilities and annual revenues exceed RUB 1 trillion according to the IFRS.

[28] Loans, banks' investment in bonds except those transferred under repo agreements, and bonds transferred to a bank under repo agreements.

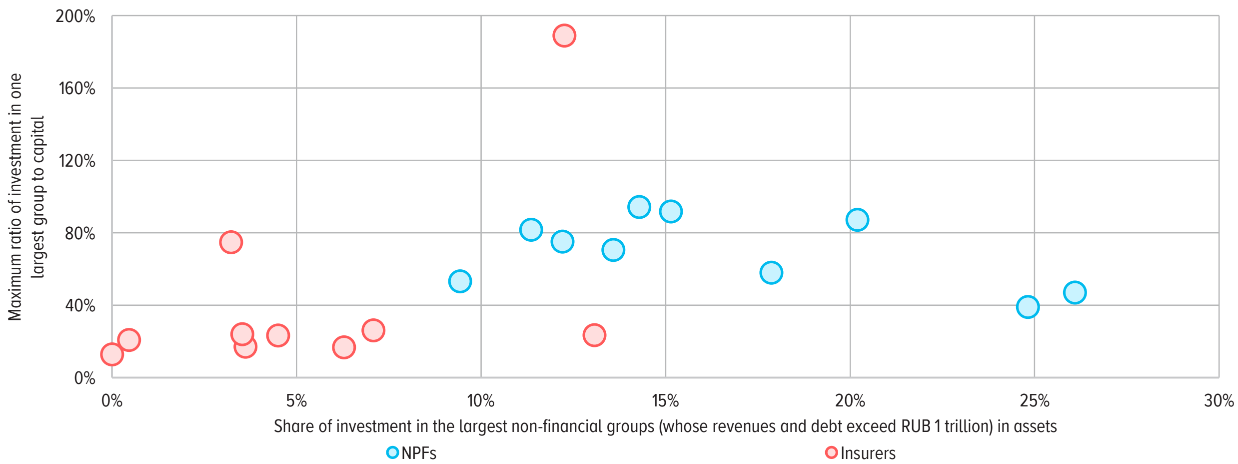
[29] LEX – large exposures, LEX30 – exposure measurement, BCBS.

RATIO OF THE LARGEST COMPANIES' OUTSTANDING DEBT TO THE BANKING SECTOR'S CAPITAL *Chart 42*
(%)



Sources: Reporting Forms 0409123, 0409303, 0409711, 0409501 and 0409603; National Clearing Centre.

CONCENTRATION RATIOS OF THE TOP-10 NPFs AND INSURERS (AS OF 31 DECEMBER 2023) *Chart 43*



Sources: Reporting Forms 0420154, 0420125, 0420865, 0420864, 0420201 and 0420502.

is going to cancel the easing in relation to the N6 ratio[30] calculation for the loans of sanctioned companies. Furthermore, the regulator will modify the approach to assessing credit risk on repos within the N6 ratio (where an issuer does not have a high credit rating). In the future, the Bank of Russia will consider the need to gradually cancel the use of risk ratios below 100% in the calculation of concentration ratios. In order to tighten the N25[31] ratio calculation, the Bank of Russia will expand the list of persons related to a bank by including in it persons controlled by a shareholder or the bank or materially influenced by close relatives of persons related to the bank. In 2025, to oblige banks to comply with the N30 ratio for SIBs, it is planned to develop a draft law that would be implemented stage by stage and help limit concentration risks more conservatively.

To reduce concentration risk, it would be reasonable to develop syndicated lending to major projects for the contracting parties to share the risk. Furthermore, it is essential for companies themselves to maintain adequate debt burden levels in the current environment.

[30] The maximum risk ratio per borrower or group of related borrowers.

[31] The maximum risk ratio per entity related to a bank (a group of entities related to a bank).

In contrast to banks, concentration risks in the insurance and pension markets had somewhat weakened by 2023, following the launch of the supervisory stress testing for NPFs (from 2018) and inclusion of concentration risk in the calculation of the regulatory equity-to-liabilities ratio set for insurers (from 2021). Besides, in 2023 amid the growth of NPFs' investment in OFZs, their exposure to the largest non-financial companies slightly decreased, specifically from 18.4% to 17.0% of the assets. Considering that the share of investment in the banking sector is large, insurers' direct exposure to the largest non-financial companies is low, namely 6.1%. Open-end and exchange-traded UIFs' exposure to the largest companies remained unchanged compared to the end of 2021, specifically 17.2%.

However, concentration risk is still significant for a number of NBFIs. As of the end of 2023, the concentration risk component in the regulatory equity-to-liabilities ratio set for insurers amounted to RUB 55.7 billion, or 27.7% of the overall risk assessment. The asset-weighted ratio of investment in the largest investee to equity averages 42.2% among insurers and 66.8% among NPFs. Moreover, some companies' maximum concentration on the largest group of related entities exceeds 80% of capital.

In addition, the compositions of key counterparties and companies – investees are overlapping in the portfolios of some NBFIs. Taking into account the established practice, potential negative implications of insured events or financial troubles facing NBFIs' largest counterparties might affect both their business (in the form of insurance payments or phasing-out of pension programmes) and investment portfolios.

3.5. Banks' interest rate risk

Amid the rise in the cost of funding driven by higher interest rates, banks' net interest margin edged down in Q1 2024 from 4.8% to 4.5%. The revaluation of the bond trading book did not have a significant effect on the banking sector either. The negative revaluation of the bond trading book in Q4 2023–Q1 2024 amounted to RUB 127.5 billion (0.7% of face value of the bond portfolio, or 0.8% of the banking sector's capital) on the back of rising OFZ and corporate bond yields. The accumulated while unrecognised negative revaluation of the portfolio of bonds measured at amortised cost totalled RUB 0.5 trillion as of 1 April 2024, which is also a sufficiently moderate amount (0.4 pp of banks' capital adequacy ratio N1.0). Hence, the need to sell such securities would not involve risks to credit institutions' financial resilience.

Despite the existing budget deficit, the Russian Ministry of Finance continues to increase borrowings in the domestic market. As a result, the OFZ market might expand by RUB 2.6 trillion (1.5% of GDP) over 2024. The growth of borrowings and persistent inflationary pressures are driving OFZ yields higher, thus increasing the cost of borrowings for corporates further. Accordingly, the spread between corporate and government bond yields widened in recent months.

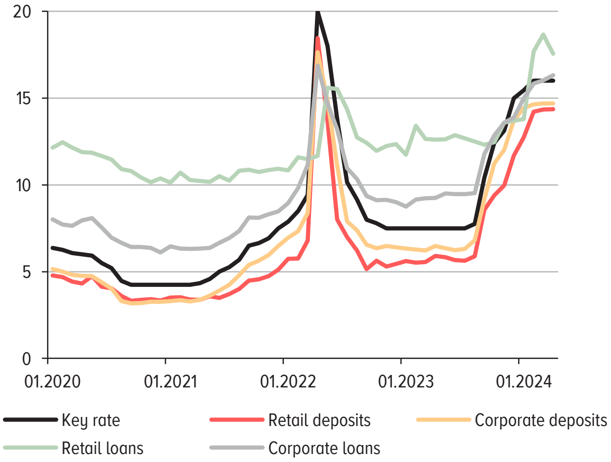
To ensure stable bond market, it is essential to maintain fiscal sustainability and return inflation back to the target, which will be ensured by the Bank of Russia's monetary policy.

1. Net interest margin (NIM) declined amid rising funding costs but remains high

Given the increase in money market rates since July 2023 (Chart 44), the growth of funding costs caused a reduction in banks' NIM, specifically from 4.8% to 4.5% in Q1 2024 (Chart 46). The decline in NII and the growth of performing assets accounted for 0.2 pp and 0.1 pp of the NIM decrease, respectively.

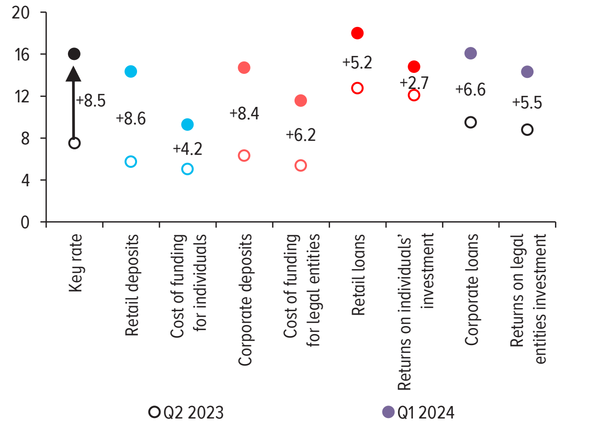
Banks' net interest income (NII) contracted primarily due to soaring interest expenses for retail and corporate deposits. Nevertheless, banks' sensitivity to interest rate risk in the banking book (IRRBB) was limited, given that there was a considerable proportion of accounts where interest

CREDIT AND DEPOSIT RATES *Chart 44*
(%)



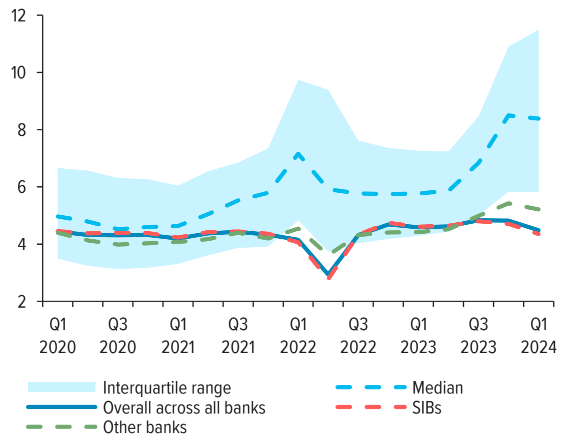
Source: Bank of Russia, in rubles.

CHANGES OF QUARTERLY AVERAGE INDICATORS FROM Q2 2023 TO Q1 2024 *Chart 45*
(%)



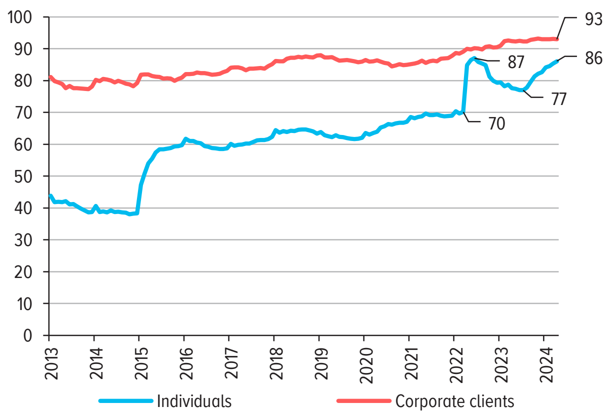
Source: Bank of Russia, in rubles.

QUARTERLY NIM ACROSS GROUPS OF BANKS *Chart 46*
(%)



** All banks, except the BNA.*
Sources: Reporting Forms 0409102 and 0409101.

SHARE OF SHORT-TERM RUBLE LIABILITIES (UP TO ONE YEAR, INCLUDING FUNDS IN ACCOUNTS) TO INDIVIDUALS AND CORPORATE CLIENTS *Chart 47*
(%)



Source: Reporting Form 0409101.

rates increased not as significantly as interest rates on new deposits. Thus, from the beginning of Q3 2023 to Q1 2024, the actual cost of funding from household funds in rubles rose by 4.2 pp and that from corporate funds – by 6.2 pp, while interest rates on new deposits were up by 8.1 pp and 8.3 pp, respectively (Chart 45).

The banking sector's NIM remains high, enabling banks to stay resilient to interest rate risk. However, there are banks (about 20% of the total number) whose NIM is below 4.5%. Their weighted average NIM declined from 3.2% in Q3 2023 to 2.4% in Q1 2024. As banks have a large share of short-term liabilities (Chart 47), this causes a surge in their interest expenses during the period of rising interest rates. In order to encourage banks to expand the proportion of long-term funding, the Bank of Russia proposes amendments to the laws, specifically an increase in the limit of insurance compensation and a reduction in the rates of contributions to the Compulsory Deposit Insurance Fund (CDIF) for deposits with maturities of over three years, irrevocable savings certificates with maturities of over one year, and escrow accounts. Currently, the concept is under discussion with market participants, State Corporation Deposit Insurance Agency, and the Ministry of Finance of the Russian Federation.

2. The baseline assessment of IRRBB over a one-year horizon approximates 0.8% of the banking sector's capital

As of 1 April 2024, given the structure of the interest rate gap in rubles, the assessment of the banking sector's interest rate risk in the banking book over a one-year horizon in the case of an additional 2 pp rise in interest rates equals about 2.0–5.0%[32] of the banking sector's annual NII (the baseline assessment and the assessment considering behavioural assumptions, respectively), or 0.8–2.0% of the banking sector's capital, or 0.1–0.2 pp of NIM. Currently, Russia does not have any regulatory limits on the amount of interest rate risk or a countercyclical approach to regulating the amount of IRRBB. The assessment of banks' economic position does take into account individual elements of interest rate risk, but growth in IRRBB does not increase the burden on capital. In view of this, it is essential for banks to enhance the quality of IRRBB management. Banks can contribute to a decrease in systemic interest rate risk by applying up-to-date approaches to assessing interest rate risk[33] and improving the ratio of assets and liabilities in terms of maturities. The Bank of Russia has started to standardise the IRRBB regulation to take into account the risks of inefficient hedging of the banking book / using scheme-type derivatives. The IRRBB regulation is planned to be developed and implemented in 2025.

3. Devaluation of bonds in the trading book over October 2023–March 2024 amounted to less than 1% of the banking sector's capital

Investment in ruble bonds in the banking sector's portfolio increased by RUB 1.1 trillion over the past two quarters to reach RUB 19.2 trillion, or 11.2% of the banking sector's assets as of the beginning of April 2024. The expansion of investment was driven by both corporate bonds and OFZs in banking books that increased by RUB 662 billion and RUB 465 billion, respectively, over the said period. Nevertheless, OFZs still account for the largest share of investment in bonds (70.7% of the total bond portfolio and 72.4% as of the beginning of October 2023).

OFZ and corporate bond yields continued to rise in Q4 2023–Q1 2024. Over this period, OFZ yields went up by 172 bp on average along the curve, and indicative yields on corporate bonds (RUCBTRNS) increased by 206 bp. In contrast to the previous months when yields had been growing primarily for short maturities, yields during the period under review were going up for long maturities as well. Amid the rise in yields, the actual negative revaluation of the banking sector's ruble bond portfolio increased to RUB 127.5 billion,[34] or 0.7% of face value of the bond portfolio, or 0.8% of the banking sector's capital. The revaluation amount was quite small because the share of securities recognised in accounts at amortised cost (not subject to revaluation and normally held to maturity) remained high. Overall, 24% of all investment in OFZs and 43% of investment in corporate bonds are recognised in accounts at amortised cost (Chart 48); over the period under review, the negative revaluation for them would amount to RUB 71.3 billion.

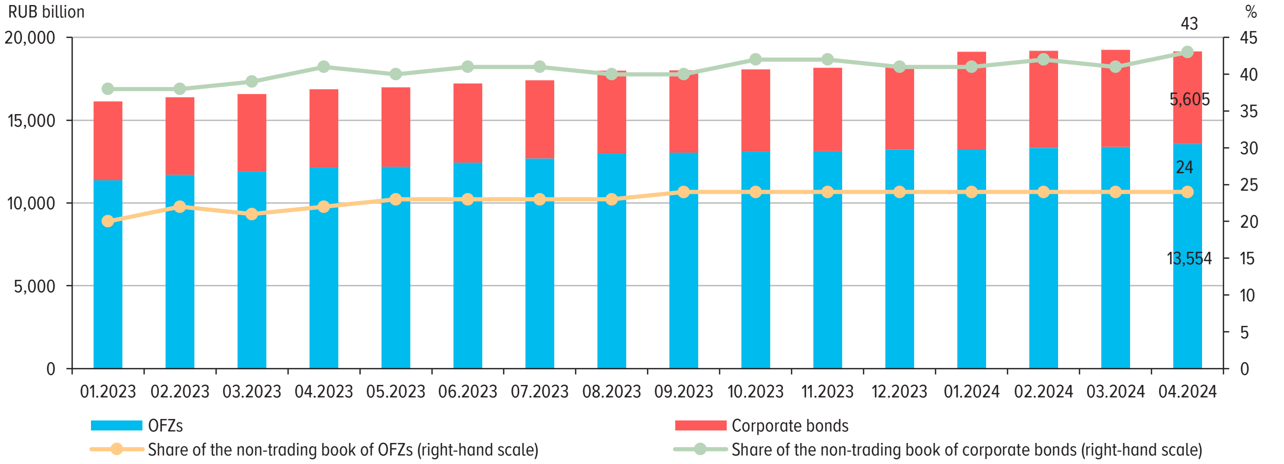
The low amount of the negative revaluation of the bond portfolio was also associated with a high share of variable coupon securities in the portfolio. During the period of quickly rising interest rates in the economy, in H2 2023, the banking sector was actively expanding its investment primarily in variable coupon securities that perform the protection function during periods of growing interest rates in the market. As of 1 April 2024, variable coupon bonds accounted for 46% in the banking book (Chart 49), with OFZ-PK bonds making up 80.9% of the said proportion (RUB 7.14 trillion at

[32] The estimated amount of the banking sector's interest rate risk in the banking book in rubles over a one-year horizon if, hypothetically, interest rates rise by 2 pp.

[33] Bank of Russia Methodological Recommendations No. 8-MR, dated 9 July 2020, 'On Calculating Interest Rate Risk on Assets (Claims) and Liabilities of a Credit Institution (Banking Group)', including the amendments.

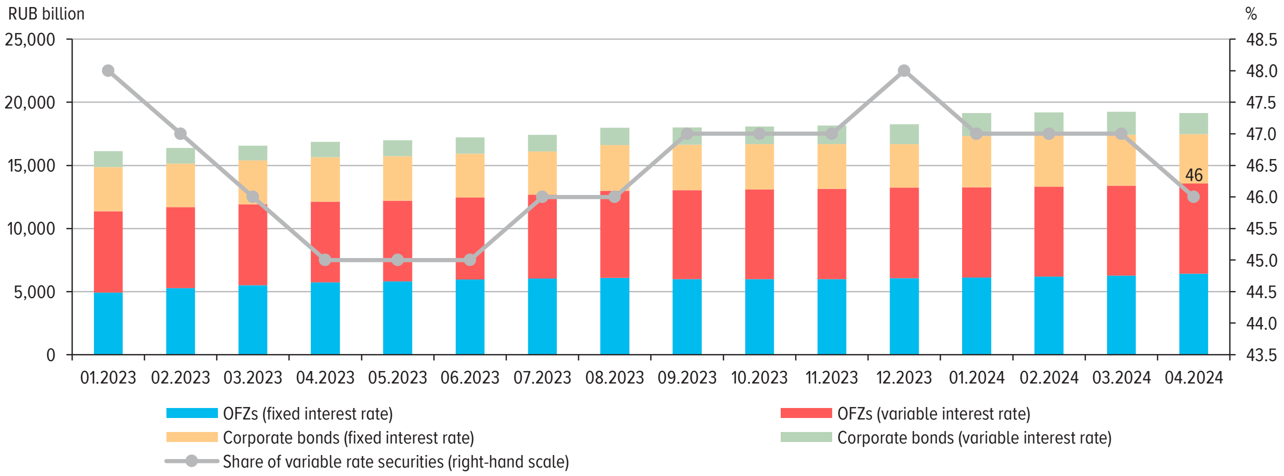
[34] The actual amount of the revaluation of the banking sector's ruble bond portfolio was calculated including balance sheet subaccounts (securities recognised at amortised cost were not revaluated). The revaluation was assessed based on the recent data on the securities portfolio (as of 1 April 2024).

BOND PORTFOLIO (AT FACE VALUE) HELD BY THE BANKING SECTOR AND THE SHARE OF THE NON-TRADING* BOOK *Chart 48*



** Non-trading book – securities recognised at amortised cost and held to maturity.*
Source: Reporting Form 0409711.

BONDS (FACE VALUE) HELD BY THE BANKING SECTOR AND THE SHARE OF VARIABLE RATE SECURITIES *Chart 49*



Source: Reporting Form 0409711.

face value), which significantly reduces banks' exposure to interest rate risk. Over the period under review, the actual revaluation of variable interest rate bonds[35] was positive and, therefore, decreased the overall amount of the negative revaluation of the securities portfolio by RUB 53.7 billion. The positive revaluation of variable coupon securities was observed amid high demand for them in autumn 2023.

As the Russian Ministry of Finance was increasingly offering fixed yield bonds, over December 2023–March 2024, fixed coupon securities accounted for RUB 805 billion of the growth rate of banks' bond portfolio, while variable coupon securities – for RUB 89 billion.

4. Interrelation between interest rate and liquidity risks

In addition to the direct effect of higher interest rates on banks' capital adequacy (the negative revaluation of the trading book and the pressure on NIM), it is important to take into account banks' exposure to interest rate risk in case of hypothetical materialisation of liquidity risk if a bank

[35] Variable coupon securities are RUONIA-linked for the most part.

needs to sell securities held to maturity whose fair value would be below their balance sheet value and, accordingly, to record a negative revaluation (as was the case in the US banking sector in spring 2023). If a bank is forced to sell securities from the non-trading book, the accumulated negative revaluation might adversely affect the bank's resilience. As of 1 April 2024, the accumulated while unrecognised negative revaluation of the banking sector's bond portfolio totalled RUB 0.5 trillion, and this amount may be considered to be limited (about 0.4 pp of banks' capital adequacy ratio N1.0). Furthermore, bonds that the Bank of Russia accepts as collateral for refinancing operations account for a considerable part of banks' portfolio of bonds recognised at amortised cost, which additionally reduces the above risks (that is, banks will most likely not need to sell the bonds).

5. Influence of public debt growth

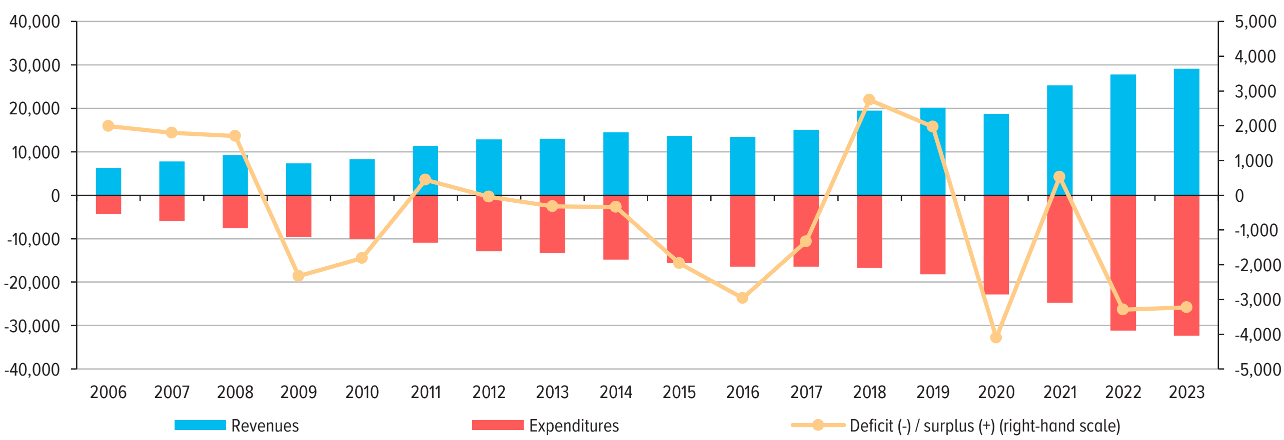
The budget deficit totalled RUB 3.2 trillion (1.9% of GDP) as of the end of 2023, which is close to RUB 3.3 trillion in 2022. The main reason why the budget deficit remained high was the continuing increase in federal budget expenditures that rose by 4.0% YoY to RUB 32.4 trillion (Chart 50). Over January–March 2024, the budget deficit amounted to RUB 0.6 trillion (Table 7). The deficit formed despite the surge in budget revenues by 53.5% YoY because of the expansion of budget expenditures by 20.1% from RUB 7.8 trillion to RUB 9.3 trillion to make considerable advance payments under state contracts.

The planned deficit of the federal budget in 2024 totals RUB 1.6 trillion. However, there are new development programmes scheduled for 2025–2030, which will require an increase in financing. In 2024, the Russian Ministry of Finance plans to borrow RUB 4.07 trillion gross through the placement of public debt (net borrowings will amount to RUB 2.6 trillion, or 1.5% of GDP). This is driving OFZ yields higher, primarily in the long-term segment. Short-term and medium-term OFZ yields are affected by expectations about the period of tight monetary policy that market participants adjust depending on how persistent inflationary pressures are. In turn, the rise in funding costs of the Russian Ministry of Finance entails a rise in the cost of borrowings for corporates as well. The spread between corporate and government bond yields expanded from 53 bp in September 2023 to 115 bp in April 2024.

The demand for OFZs is driven by both banks (mostly SIBs) and other market participants, specifically NBFIs within trust management. Currently, SIBs cover the deficit of HLAs, taken into account for the LCR calculation, primarily by loans raised from the Bank of Russia and the ICL limit (for details, see Subsection 4.1 'Assessment of the banking sector's resilience'). Given the reintroduction of the requirements for the LCR, SIBs tend to demonstrate higher demand for OFZs. SIBs increased

BUDGET REVENUES / EXPENDITURES AND SURPLUS / DEFICIT
(RUB BILLION)

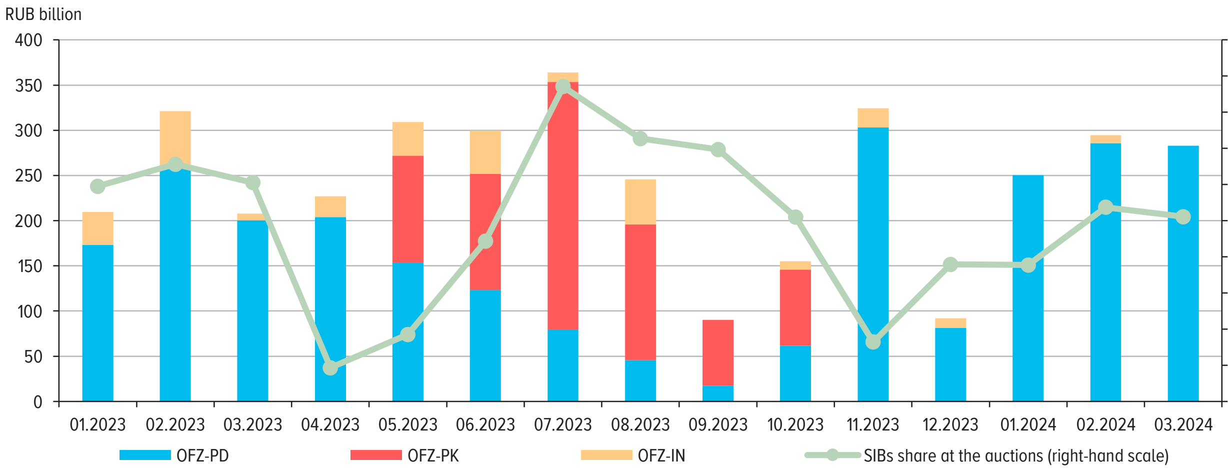
Chart 50



Source: Ministry of Finance of the Russian Federation.

OFZ AUCTIONS BY SECURITIES TYPES AND SIBS' SHARE AT THE AUCTIONS

Chart 51



Sources: Ministry of Finance of the Russian Federation, Moscow Exchange.

BUDGET REVENUES / EXPENDITURES AND SURPLUS / DEFICIT IN JANUARY–MARCH 2024 (RUB BILLION)

Table 7

	January–March 2024	January–March 2023	YoY	Approved by Federal Law No. 540-FZ. dated 27 November 2023
Revenues	**8,719**	**5,679**	**53.50%**	**35,065**
Oil and gas revenues. including:	2,928	1,635	79.10%	11,504
basic oil and gas revenues	*2,524*	*1,930*	*30.70%*	*9,683*
Non-oil and gas revenues. including:	5,791	4,044	43.20%	23,561
VAT (production and imports)	*3,356*	*2,693*	*24.60%*	*12,491*
Expenditures	**9,326**	**7,765**	**20.10%**	**36,661**
Deficit	**-607**	**-2,086**	**1,479**	**-1,595**
% of GDP	*-0.30%*	*-1.20%*	–	*-0.90%*

Source: Ministry of Finance of the Russian Federation.

their share in OFZ offerings in the primary market from 16.4% in November 2023 to 51.1% in March 2024 (Chart 51). Despite the continuing OFZ-PD sales in the secondary on-exchange market, the overall growth of SIBs' net purchases sped up to total RUB 301 billion from the beginning of 2024 (SIBs' net OFZ-PD purchases in the primary and secondary on-exchange markets amounted to RUB 74 billion in Q4 2023 and RUB 349 billion over 2023). In contrast to SIBs, other banks do not make significant OFZ-PD purchases in the primary market, and their investment over Q1 2024 increased only by RUB 29 billion (Table 8).

Fiscal sustainability risks are very limited as Russia's sovereign debt has been historically low and the Russian Ministry of Finance has been pursuing a conservative fiscal policy. Furthermore, to maintain stable bond market, it is essential to return inflation to the target, which will be facilitated by the Bank of Russia's monetary policy.

OFZ-PD PURCHASES / SALES BY BANKS IN THE PRIMARY AND SECONDARY STOCK EXCHANGE MARKETS *Table 8*
(RUB BILLION)

	SIBs – auction	SIBs – secondary stock exchange market	SIBs – total	Other banks – auction	Other banks – secondary stock exchange market	Other banks – total
Q1 2023	387.6	-39.4	348.2	44.6	-6.5	38.1
Q2 2023	66.7	-88.6	-22.0	73.2	-21.4	51.8
Q3 2023	54.4	-106.0	-51.6	15.2	-26.1	-10.9
Q4 2023	80.3	-6.4	73.9	14.5	-34.3	-19.8
Q1 2024	347.5	-46.1	301.3	64.3	-35.1	29.2
Amount	936.5	-286.6	650.0	211.8	-123.5	88.4

Sources: Ministry of Finance of the Russian Federation, Moscow Exchange.

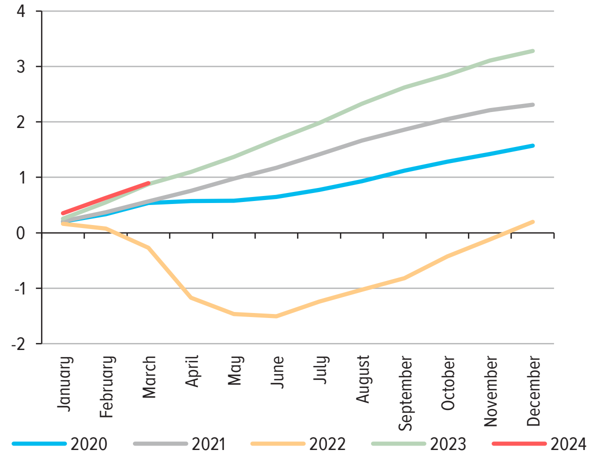
4. ASSESSMENT OF THE FINANCIAL SECTOR'S RESILIENCE

4.1. Assessment of the banking sector's resilience

As a result of increased profits, banks' capital adequacy remained almost the same over the period under review, equalling 12.1% as of 1 April 2024. Banks increased their capitalisation from profits and used it to expand lending. Concurrently, returns on assets[1] edged down from 2.6% to 2.1% by 1 April 2024 mostly because of the negative foreign currency revaluation in Q4 2023 amid the strengthening of the ruble. The ratio of the 'economic' OCP to capital remained moderate at about 4% on average.

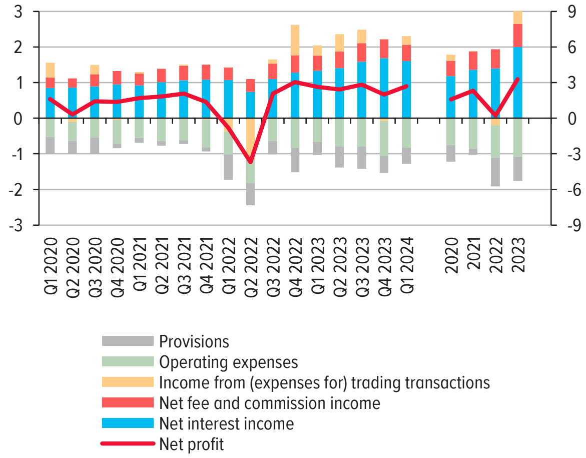
Net profit of the banking sector[1] totalled RUB 0.9 trillion as of the end of Q1 2024, which is comparable with the amount earned over the same period last year (Chart 52). The banking sector

PROFIT OF THE BANKING SECTOR*, CUMULATIVE, YEAR-TO-DATE *Chart 52*
(RUB TRILLION)



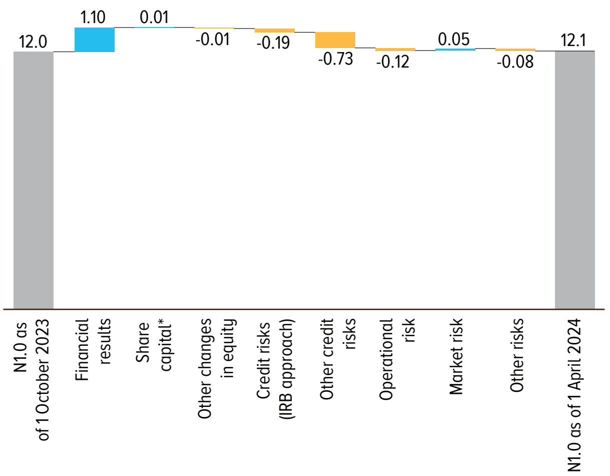
** For all credit institutions, except the BNA.*
Source: Reporting Form 0409101.

STRUCTURE OF THE BANKING SECTOR'S PROFIT *Chart 53*
(RUB TRILLION)



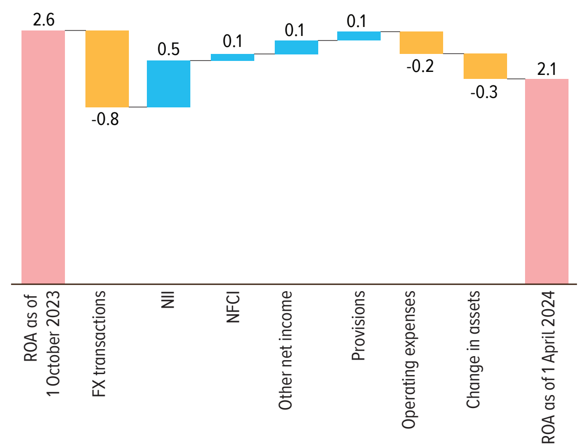
** For all credit institutions, except the BNA.*
Source: Reporting Form 0409102.

BANKS' CAPITAL ADEQUACY FROM 1 OCTOBER 2023 TO 1 APRIL 2024 *Chart 54*
(PP)



** Including the share premium.*
Sources: Reporting Forms 0409135 and 0409123.

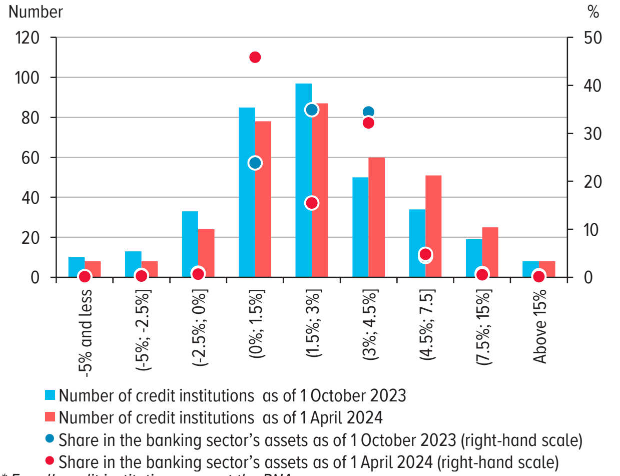
RETURNS ON THE BANKING SECTOR'S ASSETS* FROM 1 OCTOBER 2023 TO 1 APRIL 2024 *Chart 55*
(PP)



** For all credit institutions, except the BNA.*
Sources: Reporting Forms 0409101 and 0409102.

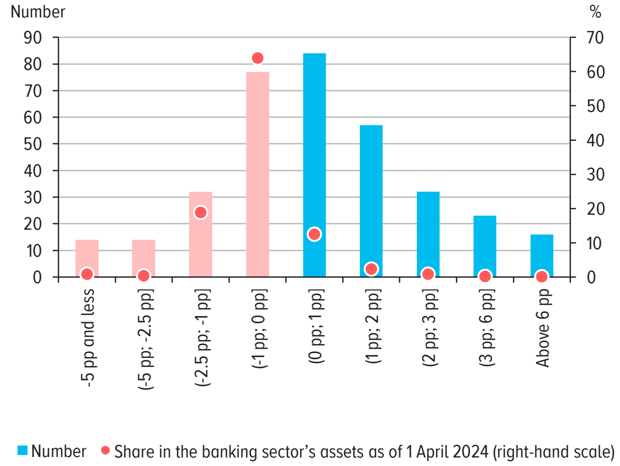
[1] For all credit institutions, except the BNA.

DISTRIBUTION OF ANNUAL RETURNS ON THE BANKING SECTOR'S ASSETS *Chart 56*



** For all credit institutions, except the BNA.*
Source: Reporting Form 0409101.

DISTRIBUTION OF CHANGES IN ANNUAL RETURNS ON THE BANKING SECTOR'S ASSETS FROM 1 OCTOBER 2023 TO 1 APRIL 2024 *Chart 57*



** For all credit institutions, except the BNA.*
Source: Reporting Form 0409101.

was able to maintain profit at the level of Q1 2023 owing to interest income (including a high share of corporate loans at variable interest rates), fee and commission income, and the restoration of corporate loan provisions.

As a result of higher profits, banks' capital adequacy increased over the six months under review from 12.0 to 12.1 as of 1 April 2024. The main drivers of capital adequacy were financial performance (+1.1 pp to the capital adequacy ratio N1.0) and a certain reduction in market risks (+0.1 pp). Banks increased their capitalisation from profits and used it to expand lending (-0.7 pp) and absorb operational risk (-0.1 pp) and other risks (-0.1 pp). Owing to the macroprudential add-ons in consumer and mortgage lending, banks' capital buffer accumulated as of 1 April 2024 reached RUB 725 billion.

Contrastingly, annual returns on assets declined from 2.6% to 2.1% as of 1 April 2024 amid the negative foreign currency revaluation (the contribution of net income from foreign currency transactions to ROA dynamics amounted to -0.8 pp on the back of the ruble strengthening) and the surge in assets. Returns on assets were supported by higher NII and NFCI (+0.6 pp to ROA) and a decrease in additional provisions in Q4 2023 vs Q4 2022 (+0.1 pp to ROA). The decline in the banking sector's profitability was associated primarily with the largest banks' dynamics. The majority of other banks increased their profitability. The number of banks with profitability below the sector's medium level declined.

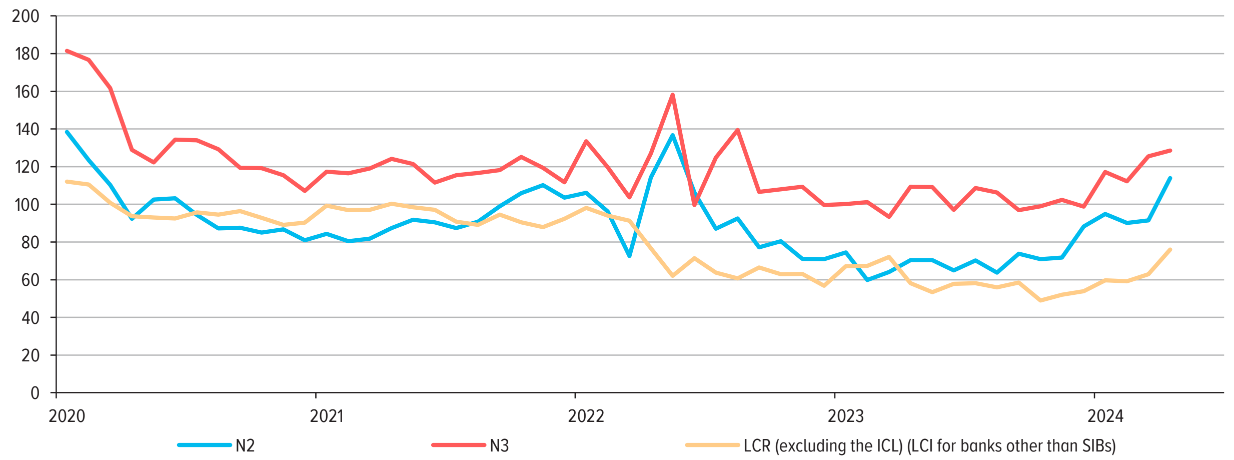
Over the period under review, banks' net long OCP remained high, increasing from USD 10.6 billion to USD 11.2 billion. The 'economic' OCP calculated as the OCP excluding guarantees, sureties and letters of credit, was up as well, specifically from USD 5.5 billion to USD 6.2 billion. The ratio of the 'economic' OCP to regulatory capital remained moderate, declining from 4.5% as of 1 October 2023 to 4.3% as of 1 April 2024.

The liquidity ratios across the group of reviewed banks[2] rose over the reporting period. As of 1 April 2024, the actual values of the N2 and N3 ratios increased from 71% to 114% and from 99% to 129%, respectively. As of 1 April 2024, the LCR excluding the ICL across SIBs in general rose from 48% to 80%.

As of the end of March 2024, the surge in the LCR was associated with the substitution of funds raised from banks and legal entities with funds from the Bank of Russia secured by non-marketable

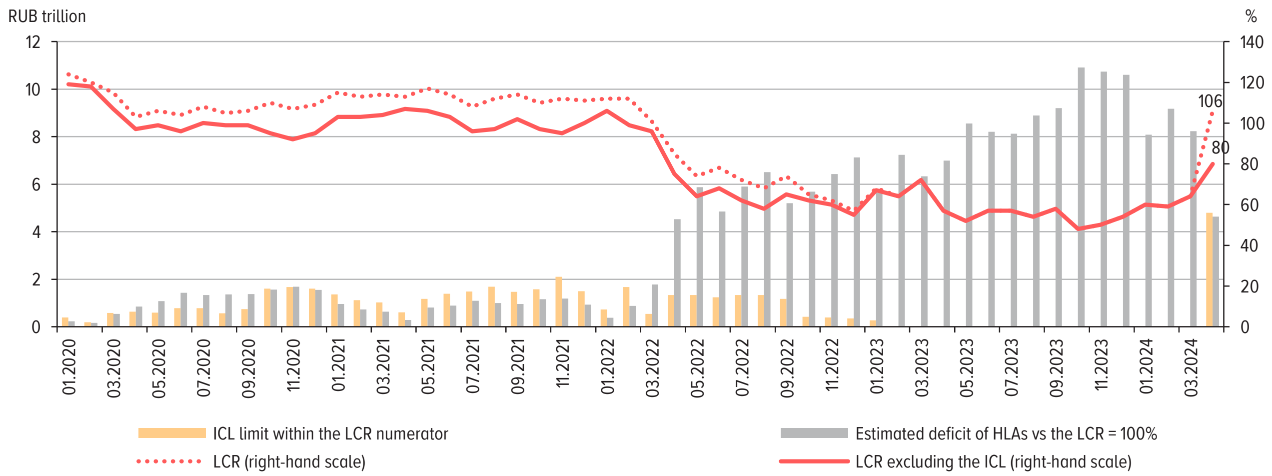
[2] Banks reporting on the N2, N3 and LCR ratios, excluding those under financial resolution carried out by the State Corporation Deposit Insurance Agency.

LIQUIDITY RATIOS (N2, N3, LCR [FOR SIBs – LCR, FOR OTHER BANKS – LCI]) *Chart 58*



Sources: Reporting Forms 0409135, 0409805 and 0409122.

SIBs LIQUIDITY COVERAGE RATIO *Chart 59*



Sources: Reporting Forms 0409135 and 0409805.

assets. The growth of the LCR was also driven by a reduction in repo transactions with the Federal Treasury, as a result of which the share of OFZs previously encumbered and not included in the LCR numerator calculation increased in the composition of HLAs.

As of 1 April 2024, the estimated overall deficit of HLAs that banks need to cover the expected net outflow of short-term liabilities over the 30-day period totalled RUB 6.5 trillion, with SIBs accounting for 71% of this amount. From 1 March 2024, the Bank of Russia started to gradually roll back the regulatory easing measures related to compliance with the LCR. In this connection, nine SIBs signed agreements with the Bank of Russia to open an ICL, with the overall limit under these ICL agreements amounting to RUB 6.6 trillion. As of 1 April 2024, seven SIBs included the ICL limit in the LCR numerator worth RUB 4.8 trillion. By including the ICL limit in the LCR calculation, these SIBs increased their LCR by a total of 28 pp as of 1 April 2024.

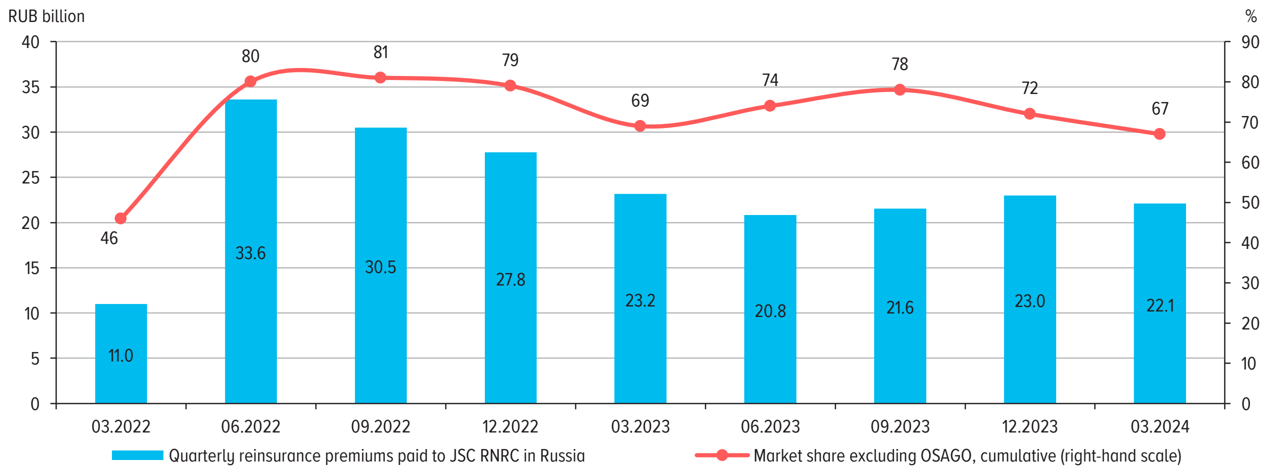
4.2. Assessment of non-bank financial institutions' resilience

In 2023, insurers and NPFs demonstrated significant business and net profit growth rates, maintaining the high quality of assets. Materialisation of a number of major insured events and higher interest rates had a moderate negative effect on their performance. The leasing market was also surging, although leasing companies are still at risk because of a decline in their capital adequacy ratio.

1. Insurers

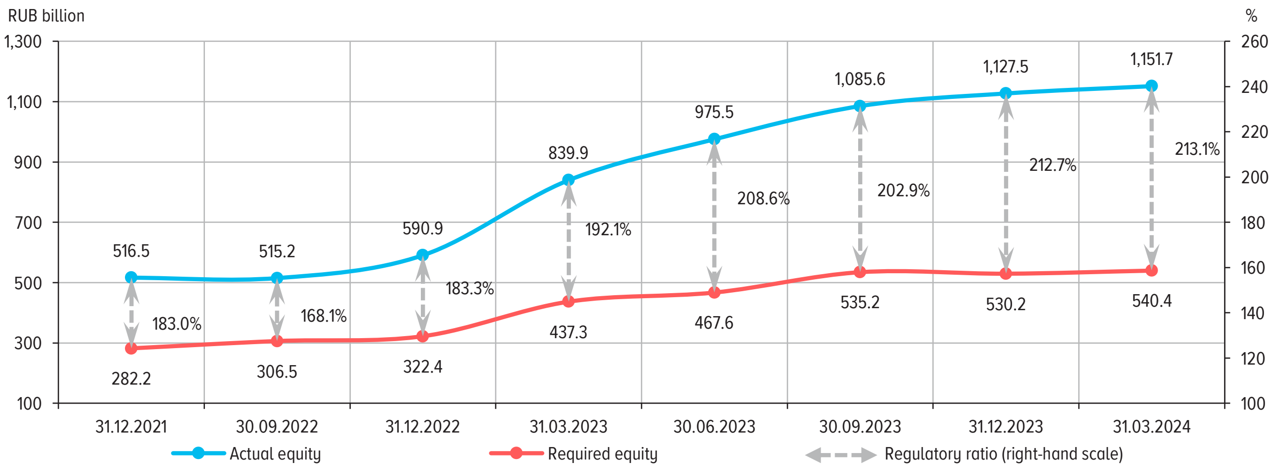
As of the end of 2023, net profit in the **insurance sector** hit a record high of RUB 322.3 billion, which is notably higher YoY. The main driver of higher profit was interest income and gains from foreign currency revaluation amounting to RUB 269.3 billion and RUB 116.6 billion, respectively. However, as of the end of Q4 2023 the industry's financial performance was negative due to losses from the core business (insurance). The annual performance was also adversely affected by losses caused by the negative revaluation of the trading book amid rising interest rates. Nevertheless,

QUARTERLY PREMIUMS TO JOINT STOCK COMPANY RUSSIAN NATIONAL REINSURANCE COMPANY (JSC RNRC) *Chart 60*



Source: Reporting Form 0420162.

STATUTORY EQUITY CAPITAL RATIO TO ASSUMED LIABILITIES *Chart 61*



Source: Reporting Form 0420156.

insurers' interest income exceeded their losses from the asset revaluation. As of the end of Q1 2024, insurers again demonstrated high net profit reaching RUB 99.0 billion.

The growth of losses incurred did not have a considerable negative impact on direct insurers' financial resilience due to the reinsurance of a significant part of risks by the Joint Stock Company Russian National Reinsurance Company (JSC RNRC). Furthermore, the achieved financial resilience enabled the national reinsurer to maintain its equity-to-liabilities ratio at a high level. It is noteworthy that JSC RNRC's market share contracted from 79% in 2022 to 67% in Q1 2024 (Chart 60).[3] Insurers have been gradually increasing self-retention of risks and developing the reinsurance capacity inside Russia.

As of the end of the year, insurers paid dividends in the amount of RUB 116.6 billion and used the remaining part of retained earnings to increase their equity. As a result, even though the required equity increased by 23.6% over the year, the regulatory equity-to-liabilities ratio rose to 213.1% (Chart 61).

2. Non-governmental pension funds

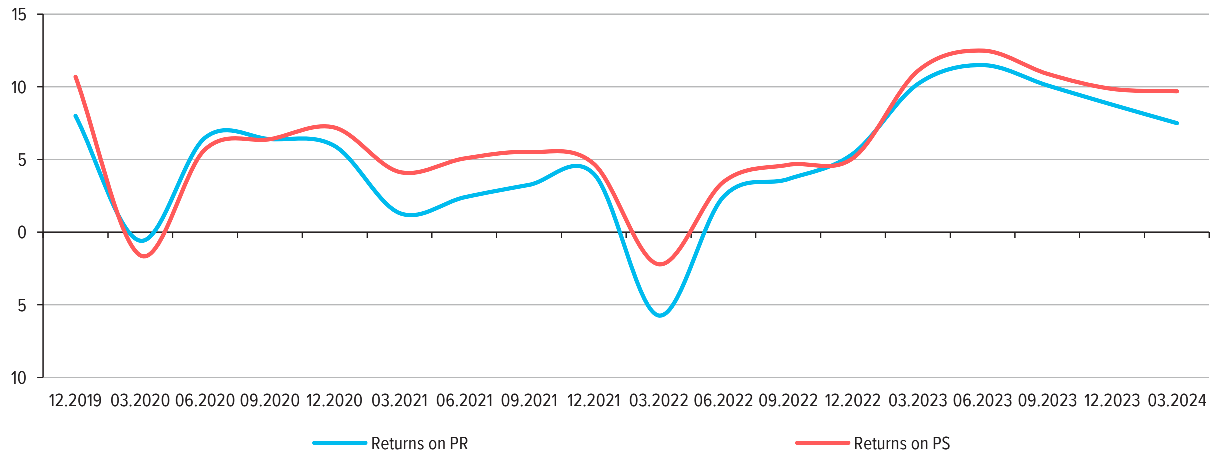
From 1 January 2024, **NPFs** started implementing long-term savings programmes enabling individuals to make savings for the future independently through their voluntary contributions and government co-financing and to transfer their earlier accumulated pension savings (PS) to the programmes. Over Q1 2024, the number of agreements signed under the long-term savings programmes exceeded 280,000, with savings contributions amounting to more than RUB 2.4 billion.

Although returns on PS and pension reserves (PR) edged down in H2 2023, they still exceeded the inflation rate. As of the end of the year, returns on PS and PR reached 9.9% and 8.8%, respectively, which is considerably higher YoY, specifically by 4.8 pp and 3.4 pp, respectively (Chart 62). NPFs' income was driven predominantly by corporate and government bond coupons (RUB 228.9 billion on PS and RUB 99.1 billion on PR) (Charts 63 and 64). NPFs' returns were up amid the stabilisation in the financial market. Over Q1 2024, annual returns on PS and PR equalled 9.7% and 7.5%, respectively.

As of the end of the year, the proportion of investment in government securities increased by 4.0 pp, whereas that of corporate bonds declined by 7.3 pp compared to the end of 2022. In Q1 2024, NPFs continued to expand their investment in government securities in their PS and

NPFs' WEIGHTED AVERAGE RETURNS
(% P.A.)

Chart 62

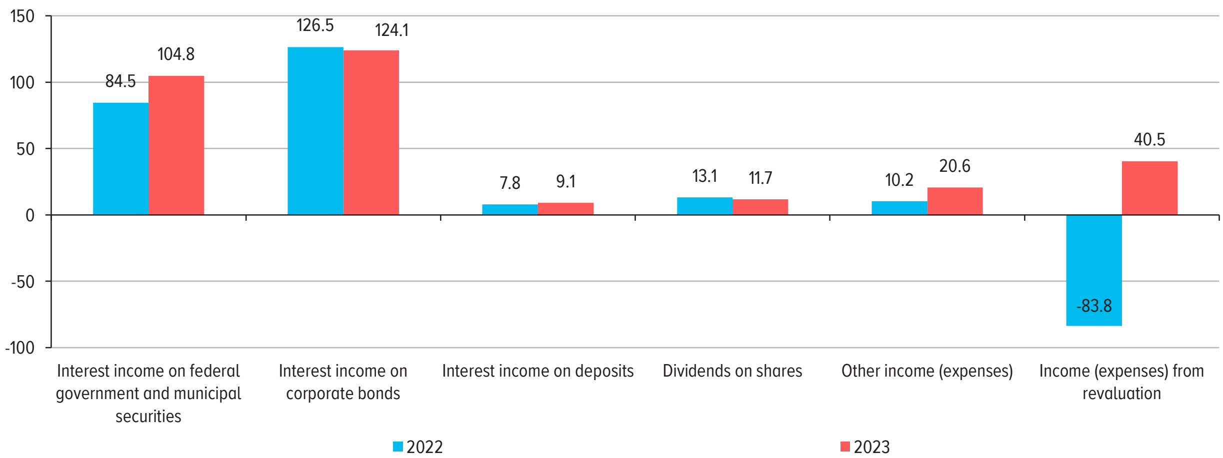


Sources: Reporting Forms 0420254 and 0420255.

[3] The ratio of insurance premiums under inward reinsurance agreements (excluding the compulsory motor third-party liability insurance, OSAGO) accepted by JSC RNRC inside Russia to total insurance premiums under outward reinsurance agreements inside Russia (excluding OSAGO).

STRUCTURE OF RETURNS ON NPFs' PR
(RUB BILLION)

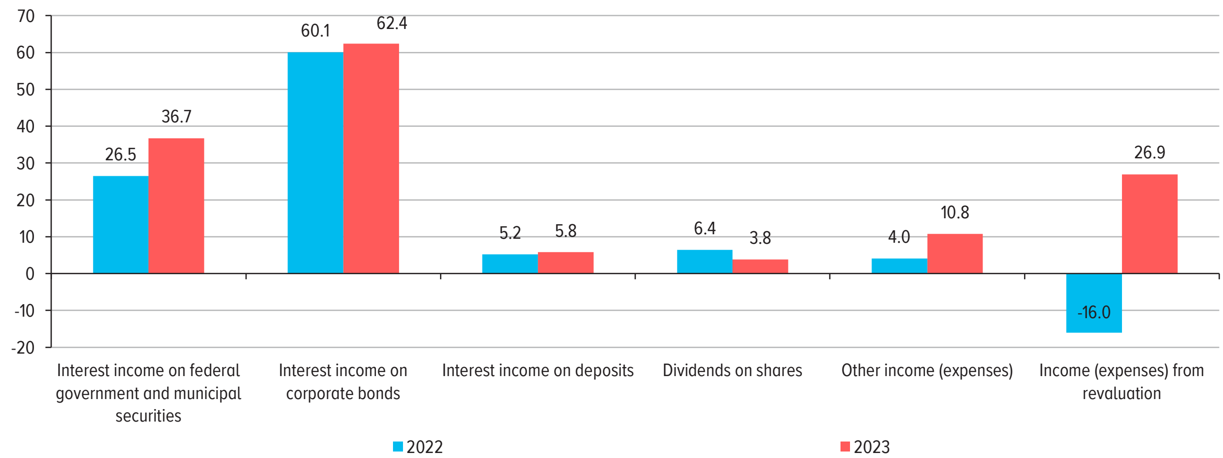
Chart 63



Source: Reporting Form 0420255.

STRUCTURE OF RETURNS ON NPFs' PR
(RUB BILLION)

Chart 64



Source: Reporting Form 0420254.

PR portfolios (+2.4 pp over the quarter). Specifically, NPFs were purchasing 11-year OFZs to their portfolios. These bonds are held to maturity, which reduces the volatility of their revaluation when interest rates are changing. As of the end of 2023, NPFs' net profit surged 1.6 times compared to 2022 to reach RUB 104.4 billion. NPFs' equity increased by 13.7% over the year to total RUB 644 billion as of the end of 2023.

3. Brokers – NBFIs

The Bank of Russia continued to phase out the regulatory easing and adjust the regulation to the sanction pressure from unfriendly jurisdictions. Thus, pursuant to the amendments to Bank of Russia Ordinance No. 5873-U[4] that became effective from the beginning of 2024, when calculating their capital adequacy ratio (CAR) brokers are not obliged to take into account the assets[5] that are

[4] Bank of Russia Ordinance No. 5873-U, dated 2 August 2021, 'On Setting the Required Capital Adequacy Ratio for Professional Securities Market Participants Engaged in Dealer, Broker, Securities Management and Forex Dealer Activities' (as amended on 9 October 2023).

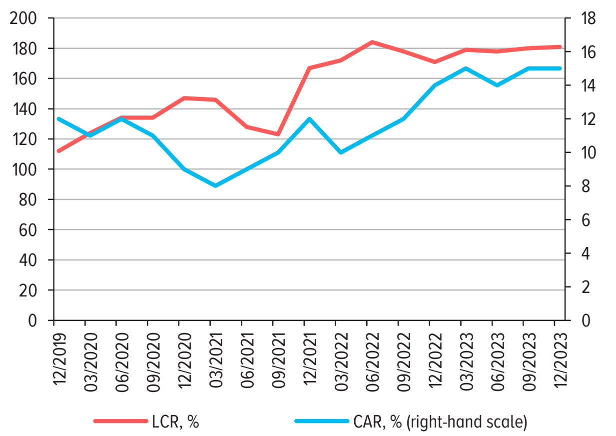
[5] Excluding Eurobonds of the Russian Federation and quasi-Russian companies.

encumbered or subject to any other restrictions preventing from using them, including because of unfriendly actions on the part of foreign states, international organisations, and foreign financial institutions. These amendments did not have a significant effect on supervised entities' financial resilience, including as a result of the decision of the Bank of Russia Board of Directors to gradually exclude the above assets from the CAR calculation throughout 2023. Over 2023 and Q1 2024, brokers – NBFIs remained compliant with the prudential ratios. Specifically, the LCR was above the regulatory value among all brokers, and the CAR dropped below the minimum only for two entities that restored it above the required ratio as of the end of the year. Furthermore, the industry continued to demonstrate an upward trend in the aggregate CAR and LCR[6] (Chart 65) that equalled 15.2% and 181%, respectively, as of the end of 2023.

Brokers' foreign exchange risks and risks related to interaction with non-residents continue to decrease. Over 2023, brokers' investment[7] in foreign shares and bonds and foreign investment funds' units (shares) plummeted from RUB 24.8 billion to RUB 9.7 billion. As of the end of 2023, professional participants' of the securities market (also NBFIs) equity and client funds in unfriendly states' currencies in the ruble equivalent contracted by RUB 36.0 billion to RUB 73.0 billion, which is 8.5% of the total balances. The amount of assets, in relation to which the counterparties are non-residents, more than halved from 17% as of the beginning of the year to 7% of the overall amount of assets.

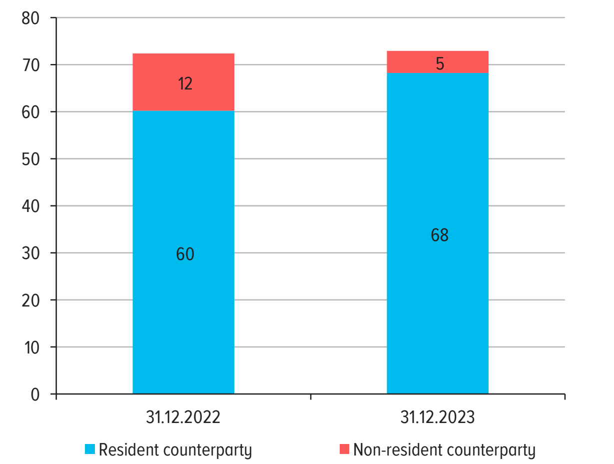
As the role of the securities market has increased, the legislative authorities continue to develop the legal framework, including to encourage individuals' long-term investment. From early 2024, investors can use a new instrument – an individual investment account (IIA) of the third type.[8] The deduction from personal income tax for people's long-term savings within type 3 IIAs combines the tax privileges granted for the earlier account types – type 1 and type 2 IIAs.[9] In addition, the minimum required period of holding savings in IIAs for an investor to be eligible for the tax deduction has been

AGGREGATE LCR AND CAR *Chart 65*
(%)



Sources: Reporting Forms 0420454, 0420455, 0420418 and 0420431.

BROKERS–NBFIS' ASSETS EXPOSED TO CREDIT RISK *Chart 66*
(RUB BILLION)



Source: Reporting Form 0420455.

[6] The aggregate CAR and LCR were calculated by aggregating all brokers' data. The values of the ratios were weighted by the proportions of the assets, the number of clients and client funds. The values of the ratios exceeding the thresholds two or more times were limited by the doubled value of the established ratio (16% and 200% for the CAR and LCR, respectively).

[7] The value of non-residents' securities (excluding Russian companies' securities listed abroad) held by brokers directly or indirectly (except those transferred by an organisation without derecognition under repo transactions to trust management). According to Subsection 1.3 of Reporting Form 0420415.

[8] The new type 3 IIA has no limit on annual contributions and allows an investor to have three such accounts simultaneously and withdraw the funds in challenging life situations without closing the account or losing the tax deductions.

[9] Specifically, the new type 3 IIA provides for a tax deduction on the contributions to the IIA but not exceeding a total of RUB 400,000 a year, as well as on the returns on transactions in the type 3 IIA in the amount of up to RUB 30 million.

significantly extended and, during the transition period, will be increasing gradually from five to ten years. It is becoming more important to reduce credit risks related to this investment instrument. In view of this, type 3 IIAs will provide for investment insurance in the amount of RUB 1.4 million against the risks of bankruptcy of investors[10] opening and keeping IIAs (similarly to bank deposit insurance). The relevant draft law has been submitted to the State Duma for consideration.

4. Unit investment funds

Investment in UIFs continued to expand: over Q4 2023, the overall net inflow of investment into UIFs reached RUB 1.7 trillion. Moreover, two segments of the UIF market simultaneously recorded the historical peak of net inflows, specifically closed-end UIFs – RUB 1.6 trillion and exchange traded UIFs – RUB 144 billion. In the segment of closed-end UIFs, the inflow of investment was primarily into the funds focusing on affluent clients and including at least five unit holders. These funds' units are not in market circulation.

In the conditions of the high key rate, money market exchange-traded UIFs are becoming increasingly attractive, remaining a key driver for retail UIFs.[11] Money market exchange-traded UIFs' strategies provide for investment in short-term bonds, deposits and repos with the central counterparty (CC). In this regard, it should be noted that investment in these exchange-traded UIFs also involves credit and market risks, although they are lower than those associated with investment in securities.

As before, private investors demonstrate high demand for closed-end UIFs as well. Over 2023, the net asset value (NAV) of closed-end real estate UIFs with over 100 retail unit holders surged by 20% to RUB 297 billion. The total number of unit holders of the said UIFs doubled during 2023 to 188,000, while the number of UIFs increased by 16 to reach 58. The expansion of this market segment was driven by higher real estate prices, among other factors.

5. Leasing

As of the end of 2023, **leasing companies** demonstrated a significant increase in new business, specifically by 90.6%.[12] Net investment[13] in leasing surged by 47.7% to RUB 3.1 trillion as a result of higher prices for leased assets and extensive implementation of investment programmes. By the end of 2023, leasing companies' debt to credit institutions that are the main source of funding for the leasing market approximated RUB 4.4 trillion,[14] or 6.0% of all corporate loans (+1 pp over the year), which is evidence that the leasing industry is becoming more systemically important.

In 2024, amid increasing interest rates, the expansion of the lease portfolio might be expected to slow down. Leasing companies' debt to banks edged up by as little as 2% over Q1 2024, compared to 7.5% in Q4 2023. The cost of borrowings calculated as the weighted average interest rate on loans to leasing companies rose by 0.42 pp over Q1 2024. Notably, interest margin on leasing companies' transactions remains rather high, namely 6.5 pp.

The credit risks of the lease portfolio are declining, while remaining elevated. In 2023, lessors recorded an increase in assets for sale under the cancelled contracts on their balance sheets. These assets soared 2.9 times to reach RUB 40.2 billion, or 11% of lessors' equity. The amount of seized and sold leased assets tripled. Concurrently, amid the considerable expansion of new business,

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[10] From 2024, the list of investors eligible to open IIAs has been expanded. Now, IIAs may also be opened by open-end UIFs' management companies for record-keeping of open-end UIFs' units.

[11] Open-end and exchange-traded UIFs.

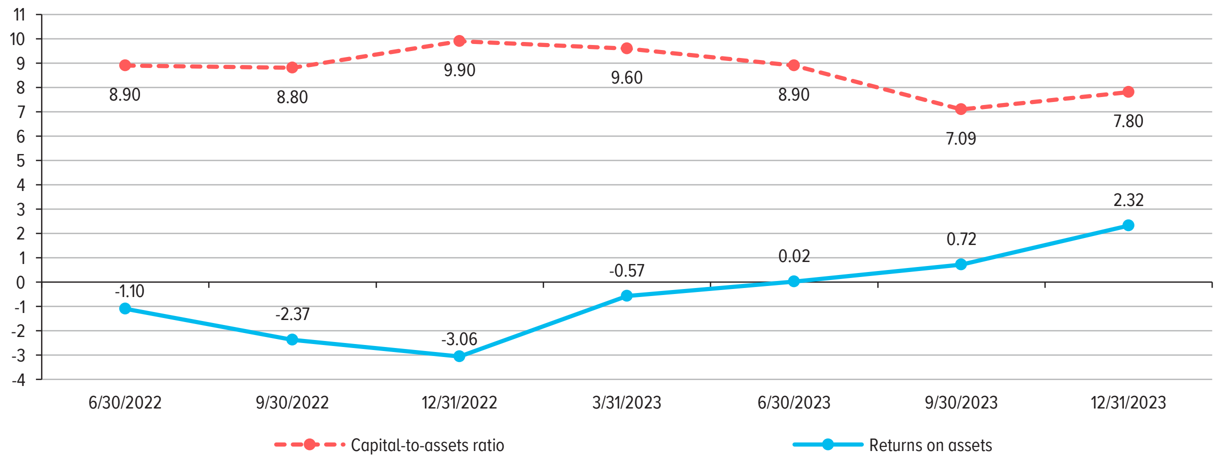
[12] Hereinafter, the information provided is based on the surveys of leasing companies, unless specified otherwise. Overall, the Bank of Russia surveyed 46 leasing companies whose lease portfolio reached RUB 7.7 trillion, or 77.8% of the Russian leasing market (according to JSC Expert RA, the market size is RUB 9.9 trillion). The sample for the analysis comprised 16 companies that had submitted their IFRS statements for the past four quarters.

[13] The lease portfolio discounted at interest rates under leasing agreements, net of reserves.

[14] According to Reporting Form 0409303.

RETURN ON ASSETS, CAPITAL-TO-ASSETS RATIO
(%)

Chart 67



Source: surveys by the Bank of Russia.

the proportion of troubled assets (taking into account restructured and cancelled agreements) contracted to 8.2% of the lease portfolio. Simultaneously, the reserve ratio edged down by 0.9 pp to 4.2% of the financial lease portfolio.

As a result of high interest margin and the release of reserves in Q4 2023, the industry's overall profit increased to RUB 96.0 billion. However, amid the surge in the leasing business, leasing companies' capital adequacy is still not high (Chart 67). As there are no regulatory capital requirements, the leasing market remains extremely sensitive to any negative changes that would require a capital cushion to cover potential losses.

ANNEX

Recent global trends in cryptoasset market regulation

Over the period under review, international organisations and national regulators continued to actively develop guidelines and requirements for cryptoasset market participants aimed at reducing the inherent risks, protecting investors, and counteracting unfair practices. Many requirements that were introduced tighten the regulation of stablecoin issuers, require cryptoasset service providers and other cryptoasset market participants to submit additional reporting, and strengthening the anti-money laundering and combating the financing of terrorism (AML / CFT) controls.

In 2024, the G20 states intend to implement the G20 Roadmap on Crypto Assets in 2023 and proposed in the IMF-FSB Synthesis Paper with recommendations to help authorities address macroeconomic and financial stability risks posed by the cryptoasset market and develop a coordinated and comprehensive approach to the regulation of the cryptoassets market (including stablecoins).

Other international initiatives include the following:

- In Q4 2023, the International Organization of Securities Commissions (IOSCO) released its final reports with policy recommendations for the cryptoasset and decentralised finance (DeFi) market regulation.
- In Q4 2023, the Basel Committee on Banking Supervision (BCBS) issued a consultative document on banks' disclosure of cryptoasset exposures, as well as amendments to its standard on prudential treatment of cryptoasset exposures to tighten the requirements for the stablecoins reserve assets.
- The Financial Action Task Force (FATF) takes measures to monitor the status of implementation of its cryptoasset recommendations by FATF members and jurisdictions with materially important activity of virtual asset service providers (VASPs) in order to reduce the AML / CFT risks. In March 2024, the FATF released the related report. According to the FATF's findings, fewer than 30% of jurisdictions around the globe had started regulating the crypto sector.

At the national level, countries implemented the following initiatives over the period under review:

The EU continues to develop a comprehensive framework within the Markets in Crypto Assets Regulation (MiCA). In particular, the EU published a number of interim documents, including those addressing such issues as: 1) disclosure of information by virtual assets service providers (VASPs) on various aspects of their activity, including cryptoasset issuance; 2) exchange of information between competent authorities for the purposes of supervision and regulation under MiCA; 3) criteria for the qualification of cryptoassets as financial instruments; 4) the provision of cryptoasset services or activities by a third-country firm to EU clients (reverse solicitation); and 5) requirements for shareholders and members of the management bodies of issuers of cryptoassets and VASPs. Furthermore, the documents specify other requirements for cryptoasset market participants, including due diligence measures and checks on the identity of VASPs' customers.

In March 2024, the USA released recommendations for the development of a common approach to classifying digital assets that comprise all possible types of digital money and cryptoassets.

Hong Kong introduced requirements for reducing crypto investors' risks by limiting retail investors' access to the cryptoasset market, to investment funds in the cryptoasset market and custodial services for digital assets, as well as developed proposals to implement a licensing regime for stablecoin issuers and regulate over-the-counter trading of virtual assets.

The UK financial regulators have recently published a number of complementary documents on cryptoassets, including proposals regarding the regulatory regime for systemic payment systems using stablecoins and related service providers, proposals for developing a regulatory regime for fiat-backed stablecoins including when used as a means of payment, and proposals for implementing the cryptoasset reporting standards of the Organisation for Economic Cooperation and Development (OECD).

Canada's regulators released draft guidelines on disclosure by banks and insurers of cryptoasset exposures, a draft regulation of investment funds seeking to invest directly or indirectly in cryptoassets, and guidance to cryptoasset trading platforms (crypto exchanges) and cryptoasset issuers clarifying stablecoin trading terms and rules.

Furthermore, the US Securities and Exchange Commission (SEC) approved 11 exchange-traded funds (ETFs) investing directly in Bitcoins (spot Bitcoin ETFs) despite the SEC's concerns over this instrument. The approval was granted as the court sided with Grayscale Investments[1] in a lawsuit against the SEC which had denied the company's application to create a spot Bitcoin ETF in 2022.[2] The launch of spot Bitcoin ETFs in the market has not resulted in a significant expansion of the base of cryptoasset investors. Furthermore, an easing of the restrictions might strengthen the correlation between the cryptoasset market and other financial market segments, which in turn might entail spillover effects in case of substantial fluctuations of cryptoasset prices and forced liquidation of other assets to offset investment portfolio losses. In addition, the IMF emphasises that the recent approval of spot Bitcoin ETFs might make Bitcoin cross-border flows more similar to traditional capital flows as financial institutions' involvement in the cryptocurrency market will be growing.

Amid expectations of the launch of spot Bitcoin ETFs, the cryptoasset market's capitalisation surged by 57.8% from 30 September 2023 through 10 January 2024. Its capitalisation increased by another 52.8% over the period from 11 January 2024 through 31 March 2024, driven by considerable inflows of funds into spot Bitcoin ETFs. Other drivers of the expansion of the cryptoasset market were the planned Bitcoin halving[3] and expected approval of spot Ethereum ETFs. As a result, over the said period, the Bitcoin price soared to a record high of USD 73,600, and the USDT capitalisation exceeded USD 100 billion for the first time.

[1] The world's largest cryptoasset manager.

[2] According to the opinion of the US Court of Appeals for the District of Columbia Circuit, the SEC failed to treat like cases alike when it had denied the listing of Grayscale's spot Bitcoin ETF, while it had earlier approved a futures Bitcoin ETF.

[3] Halving is a planned reduction in the number of newly issued bitcoins (BTC) which are created and distributed among miners as a block reward.

ABBREVIATIONS

BNA – bank of non-core assets

CHB – credit history bureau

DSTI – debt service-to-income ratio calculated as the ratio of a borrower's average monthly payments on all loans and microloans, including on a newly issued loan (microloan), to the borrower's average monthly income

ECB – European Central Bank

EIR – effective interest rate

EME – emerging market economy

ETF – exchange-traded fund

EU – European Union

GDP – gross domestic product

HLA – highly liquid asset

ICL – irrevocable credit line

IFRS – International Financial Reporting Standards

IMF – International Monetary Fund

IRB approach – internal ratings-based approach

LCI – liquidity coverage indicator

LCR – liquidity coverage ratio

LLCR – loan life coverage ratio

LNG – liquefied natural gas

LTV – loan-to-value

MFO – microfinance organisation

MPL – macroprudential limit

NBFI – non-bank financial institution

NFCI – net fee and commission income

NII – net interest income

NIM – net interest margin

NPF – non-governmental pension fund

NPL – non-performing loans

NPS – non-governmental pension system

OFZ – federal government bond

OFZ-AD – federal government bond with debt amortisation

OFZ-IN – inflation-indexed federal government bond

OFZ-PD – fixed coupon federal government bond

OFZ-PK – variable coupon federal government bond

OPEC – Organization of the Petroleum Exporting Countries

OSAGO – compulsory motor third party liability insurance

P2P – peer-to-peer transactions between individuals without intermediaries

PMI – Purchasing Managers' Index

PR – pension reserves

PS – pension savings

ROA – return on assets

SIB – systemically important bank

SEC – US Securities and Exchange Commission

SMEs – small and medium-sized enterprises

UHCIS – Unified Housing Construction Information System

UIF – unit investment fund

US Fed – US Federal Reserve System

UST – US Treasuries

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