



Bank of Russia

The Central Bank of the Russian Federation

**Financial sector size and
structure long-term forecast**

This paper presents forecasts for the development of Russia's financial sector in the long term (until 2035) based on cross-country models estimates built on 63 countries panel data (including Russia, 1980–2015) and the quality of explanation of Russia data depending on the most likely scenarios for the relevant drivers (macroeconomic, institutional and demographic).

We considered three key scenarios: target, inertial and worst-case.

The target scenario is characterised by strong macroeconomic performance and a marked improvement in the quality of institutions.

The inertial scenario is a hypothetical option where positive macroeconomic performance (as in the target scenario) is combined with institutional quality stagnation (as in the worst-case scenario).

The worst-case scenario combines sluggish macroeconomic performance with unchanged existing institutional quality and adverse demographic trends.

Virtually every scenario assumes that the supply of key types of financial instrument on the domestic market will outpace economic growth during the forecast period up to 2035. The fastest growth is expected for non-banking financial institutions and non-credit financial instruments. The latter will be driven by an increase in wealth, greater price stability and an ageing population.

Positive changes will occur in the structure of financial instruments – dedolarization and longer maturities. Key drivers include a reduction in the share of fossil fuel exports, curtailing the need for companies to borrow in foreign currency; institutional development, improvements in the quality of bank assets and an expected appreciation of the rouble accompanied by depositors' rising trust in the banking sector.

Short-term and credit financial instruments do not have the same high growth potential as long-term and equity ones do, in part because their potential has been largely realized before. Similarly, all scenarios except the worst-case assume a decrease in the role of firms' self-financing using retained earnings.

According to our estimates, all the above shifts will be much more pronounced under the target scenario. With its weaker macroeconomic performance, the worst-case scenario fails to realize in full the stimulating and "gentrifying" effect on financial sector development of the benefits of economic diversification, increased prosperity and price stability. For instance, the worst-case scenario assumes credit market stagnation relative to the economy's size, which will prevent a reduction in the share of external debt in the structure of Russian companies' debt obligations. Besides, unlike the two other scenarios, the worst-case scenario does not predict an increase in the maturities of banking sector liabilities, which could have an adverse effect on lending terms and on the efficiency of credit resources use.

Under all the scenarios except for the worst-case, the role of external financing for Russian companies will decrease and that of domestic-market financing will grow.

Under the target scenario (somewhat earlier) and the inertial scenario (later), Russia's financial sector is expected to achieve the average level of countries classified as more mature models of financial sector development by almost every measure. Not only does this open a possibility for quantitative changes in Russia's financial system, it also creates a potential for its transition to a new qualitative development level.

It is worth noting that the results of step-by-step identification of Russia as belonging to different clusters (financial sector development models) using the EM algorithm demonstrated that Russia had moved up to the cluster of countries with a higher level of financial development as early as 2014, before being pushed back by the destabilization that followed.

	Size	2010	2014	2025	2035
Panel 1: Financial sector size indicators					
Private sector loans, actual	% of GDP	44.5	58.9		
Forecast, target				60.1	72.9
Forecast, institutional inertia				51.5	56.7
Forecast, worst-case				47.9	48.7
Independent pension fund assets, actual	% of GDP	1.9	2.7		
Forecast, target				7.6	9.8
Forecast, institutional inertia				7.3	9.2
Forecast, worst-case				6.9	7.9
Corporate bonds, actual	% of GDP	6.1	5.9		
Forecast, target				21.5	34.6
Forecast, institutional inertia				16.4	23.4
Forecast, worst-case				13.3	15.8
Insurance sector assets, actual	% of GDP	1.8	2.4		
Forecast, target				6.7	8.2
Forecast, institutional inertia				6.6	7.8
Forecast, worst-case				6.6	7.5
Insurance companies – life insurance (premiums), actual	% of GDP	0.0	0.1		
Forecast, target				1	1.9
Forecast, institutional inertia				0.7	1.1
Forecast, worst-case				0.7	0.9
Insurance companies – except life insurance (premiums), actual	% of GDP	0.9	0.9		
Forecast, target				1.0	1.1
Forecast, institutional inertia				1.0	1.0
Forecast, worst-case				0.9	0.9

	Size	2010	2014	2025	2035
Stock market capitalization, actual	% of GDP	57.5	27.8		
Forecast, target				65.9	84.4
Forecast, institutional inertia				56.2	66.1
Forecast, worst-case				49.1	58.0
Panel 2: Financial sector structure indicators					
Long- to short-term bank asset ratio	times	0.18	0.16		
Forecast, target				0.22	0.28
Forecast, institutional inertia				0.19	0.21
Forecast, worst-case				0.16	0.16
External to domestic corporate debt (private sector loans and corporate bonds) ratio	times	7.3	3.5		
Forecast, target				2.8	2.1
Forecast, institutional inertia				3.1	2.4
Forecast, worst-case				3.6	3.1
Debt (private sector loans, corporate bonds, factoring operations) to equity (stock market capitalisation) finance ratio	times	0.9	2.4		
Forecast, target				1.3	1.3
Forecast, institutional inertia				1.2	1.3
Forecast, worst-case				1.3	1.2
Banking (private sector loans) to non-banking (insurance company, independent pension fund, mutual fund assets) institutions' assets ratio	times	11.1	10.3		
Forecast, target				4.0	3.5
Forecast, institutional inertia				3.5	3.1
Forecast, worst-case				3.4	3.0
Share of foreign-currency denominated bank liabilities	% of total liabilities	28.2	34.7		
Forecast, target				25.9	21.5

	Size	2010	2014	2025	2035
Forecast, institutional inertia				27.9	27.5
Forecast, worst-case				28.1	28.1
Share of foreign-currency denominated bank loans	% of total loans	27.0	29.4		
Forecast, target				21.2	17.4
Forecast, institutional inertia				21.3	18.0
Forecast, worst-case				21.8	20.1

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