The Russian Banking System during the Covid-19 Crisis and the Central Bank's Stabilisation Measures[1]

DORINA CLICHICI, PhD.
Institute for World Economy, Romanian Academy
13 September Street, No. 13th, Bucharest
ROMANIA
dorina.clichici@iem.ro, https://iem.ro/

Abstract: The COVID-19 pandemic has significantly affected the financial situation of the individuals and companies in the Russian Federation, as a result of the mobility restrictions and lockdowns. In this context, banking system has played an important role in financing the economy. To avoid a credit crunch and to facilitate economic recovery, the Bank of Russia has adopted a wide range of stabilization measures, as cutting the key rate, easing banking capital and liquidity regulations, providing extensive liquidity, new lending facilities to banks etc. The purpose of this article is to analyse the Central Bank's response to the pandemic and to assess the financial stability of the banking system in the Russian Federation during the COVID-19 crisis. To achieve this goal, a chronology of the main measures adopted during the pandemic by the Bank of Russia is presented. In addition, the main indicators of the banking stability are analysed, namely, the level of capitalization and liquidity, the return on capital and assets, but also the quality of bank loans.

Key-Words: COVID-19 pandemic, Russian Federation, banking system, Bank of Russia, indicators of the banking stability, demand for loans

JEL Classification: G01, G21, G28

1 Introduction

The COVID-19 pandemic has significantly affected the financial situation of the individuals and companies in the Russian Federation. Major companies faced a severe drop in profits and a rise in debt levels. In addition, the decline in international oil prices and the forced reduction in oil production under the OPEC agreement in October 2020 had a negative impact on the financial position of companies in the oil and natural gas sector.

However, the Russian Federation entered the crisis under the conditions of a solid fiscal framework and substantial public policy space, which allowed the authorities to respond with quick and effective measures to recover the economy. At the same time, the fiscal consolidation that took place after the 2014 crisis helped achieve low levels of indebtedness, as well as increase contributions to the National Welfare Fund. Moreover, the consolidation took place amid the implementation of new fiscal rules, which reduced uncertainty and disconnected the budget from the volatility of international oil prices. As a result, the economy of the Russian Federation managed to reach a growth rate of 4.8% in 2021, after a decrease of 2.7% in the pandemic year (IMF, 2022). According to IMF estimates (2020), fiscal measures to respond to the pandemic crisis reached about 3.5% of GDP, or about 4.5% if extrabudgetary measures are included. The extensive measures adopted in the form of social and unemployment aid supported the incomes of households in difficulty. While fiscal support measures for companies significantly eased liquidity and solvency pressures. In addition, to avoid a credit crunch and to facilitate economic recovery, the Bank of Russia has adopted a wide range of stabilization measures, as cutting the key rate, easing banking capital and liquidity regulations, providing extensive liquidity and new lending

[1] This article is based on a more comprehensive research undertaken by the author within the study *Sistemul financiar al Federaţiei Ruse în condiţiile crizelor financiare şi economice*/*The financial system of the Russian Federation under the conditions of the financial and economic crises*, coordinated by Dr. Dorina CLICHICI, included in the research program of the Romanian Academy in 2022.

facilities to banks, etc. As a result, the banking sector has managed to provide credit to individuals and companies in difficulty, while remaining stable at the same time.

2 Financial stabilization measures adopted by the Bank of Russia during the pandemic

To mitigate the effects of the pandemic on the banking sector and to avoid a credit crunch, the Bank of Russia intervened through a series of stabilization measures (Table 1). The monetary authority relaxed the regulations regarding loan classification and provisioning, stimulated the restructuring of loans granted to debtors in difficulty and facilitated the provision of loans to the population and companies. In order to free up additional resources in the banking system, it relaxed the macroprudential requirements for the creation of capital buffers and credit risk weighting. Due to Central Bank lending facilities and extensive liquidity operations, banks continued to provide credit to the economy. In addition, against the background of high volatility of the foreign exchange market, borrowers had the opportunity to convert loans into rubles, which helped reduce exposure to foreign currency loans. According to the IMF (2020), monetary and macroprudential policy measures implemented by the Bank of Russia contributed to limiting the economic decline in 2020.

Table 1: Financial stabilization measures adopted by the Bank of Russia in response to the COVID-19 crisis

Date of adoption	The objective pursued	Description of the measure
10.02.2020	Alleviating disinflationary pressures and facilitating lending	• Cutting the key rate from the 6.25% to 6%.
9.03.2020	Stabilization of the financial market and the exchange rate of the ruble	• Suspending the purchase of foreign currency within the budget mechanism for a period of 30 days; • Active sale of foreign currency on the domestic foreign exchange market; to increase the supply of US dollars in the banking market, the limit on foreign exchange swap operations was increased to 5 billion dollars; • Liquidity injection into the banking system, in order to avoid disrupting the banking activity and supporting lending.
17.03.2020	Facilitating lending to the small and medium enterprises (SMEs)	• Approving the new refinancing mechanism for SMEs, with a limit of 175 billion rubles. The interest rate for these refinancing operations was reduced from 6% to 4%, and the maximum level of the interest rate applied to SMEs by banks being limited to 8.5%.
20.03.2020	Supporting the population, the economy and the financial sector during the pandemic (selection)	• Recommending that credit institutions restructure debt and refrain from applying penalties and fines on loans to individual borrowers; • Entitling credit institutions not to recognise such loans as restructured for the purpose of creating reserves and not to apply macroprudential add-ons to such loans until 30 September 2020; • Entitling credit institutions not to increase reserves on loans to individual borrowers in the case of worsening of their financial standing and/or debt servicing quality, until 30 September 2020; • Expanding the refinancing programme for SMEs, beyond the currently operational limit of 175 billion rubles, an

Date of adoption	The objective pursued	Description of the measure
		additional funding of 500 billion rubles will be available, effective from 23 March 2020. • Offering easier conditions for providing irrevocable credit lines to credit institutions until 1 April 2021; the irrevocable credit line fee was be reduced from 0.5 to 0.15%; • Retaining the national countercyclical capital buffer at zero per cent; • Postponing several amendments to the regulation of credit institutions, **easing regulatory and supervisory burden for financial institutions.**
27.03.2020	Supporting vulnerable industries, retailers, financial institutions, and SMEs (selection)	• Recommending that credit institutions approve applications from retailers for debt restructuring due to an income reduction from 1 March 2020, also not to charge any increased interest, fines or penalties; • Allowing credit institutions not to classify such loans as restructured ones for loss provisioning purposes until 30 September 2020; • Recommending credit history bureaus not to record debt restructuring cases under such loans, aimed at preventing the deterioration of borrowers' credit histories; • Expanding the earlier approved package of measures aimed at supporting lending to SMEs, transport and tourism sectors (including hotel business) to the following industries: public catering; arts, sports and leisure; conference and exhibition organising; educational services etc.; • Allowing creditors not to deteriorate the debt servicing of vulnerable industries' quality assessments until 30 September 2020, regardless of the assessments of borrowers' financial standing; • Amid intensified volatility in the foreign exchange market, borrowers were encouraged to request their banks to change the currency of their loans to rubles, which will help reduce their credit exposure; • Easing the regulation of liquidity of systemically important credit institutions, by reducing the liquidity coverage ratio and raising the maximum aggregate limit under irrevocable credit lines from 1.5 to 5 trillion rubles. • Expanding the SME refinancing program by 150 billion rubles to ensure uninterrupted fulfilment of wage payment obligations
03.04.2020	Facilitating mortgage lending and the SMEs (selection)	• Individual borrowers who find themselves in a difficult situation can take advantage of credit holidays, which allowed postponing payments on mortgage loans for up to 6 months; • Cancelling add-ons to risk weights for mortgage loans issued before 1 April 2020, which allowed banks to absorb credit losses in excess of 100 billion rubles;

Date of adoption	The objective pursued	Description of the measure
		• Easing the requirements for the minimum rating of credit institutions for their participation in the new mechanism of SMEs lending support; • Expanding the Lombard List and soften the requirements for the liquidity of securities used by credit institutions in their refinancing operations;
17.04.2020	Measures to protect households, support lending to economy, and temporarily ease foreign exchange control (selection)	• Easing of prudential requirements for risk ratios related to standard mortgages to help reduce mortgage interest rates; • Expanding support programs for SMEs, by completing the framework for granting concessional loans to credit institutions, with factoring agreements. • In cases when borrowers' financial standing deteriorates due to the new coronavirus infection, the Bank of Russia allowed banks to use the assessment of financial standing, and/or a loan quality category, determined as of 1March 2020.
27.04.2020	Alleviating disinflationary pressures and facilitating lending	• Cutting the key rate from 6.0% to 5.5%.
22.06.2020	Alleviating disinflationary pressures and facilitating lending	• Cutting the key rate from 5,5% to 4,5%.
26.06.2020	Extending the effective period of the regulatory easing (selection)	• **Through 30 September 2020,** banks could open bank accounts to clients without the personal presence of an individual; • Cancelling of penalty measures for the violation of the deadlines for the transmission of information by banks to the exchange control authorities.
27.07.2020	Alleviating disinflationary pressures and facilitating lending	• Cutting the key rate from 4,5% to 4,25%.
10.08.2020	Extending regulatory easing and implementing new countercyclical measures to support the economy (selection)	• **Through 31 December 2020**, credit institutions continued to restructure loans to individuals facing a material decline in their incomes and not to charge any penalties and fines on restructured loans; • **Through 31 December 2020**, credit institutions restructured loans by converting them from foreign currency to rubles if relevant applications are received from borrowers; • **Through 31 December 2020**, credit institutions did not enforce the mortgage if an individual borrower fails on his/her obligations due to a material decline in his/her income; • Loss provisioning for loans restructured before or on 31 December 2020 was completed **by 1 July 2021;** • **Through 31 December 2020**, credit institutions were allowed not to apply macroprudential add-ons for loans granted to borrowers with confirmed COVID-19.

Date of adoption	The objective pursued	Description of the measure
18.12.2020	Extending regulatory easing (selection)	• **Retaining the value of the countercyclical capital buffer rate for the capital adequacy ratio of Russian credit institutions at zero per cent of risk-weighted assets, and leaving unchanged macroprudential add-ons to risk weights for calculating capital adequacy ratios;** • **Extending through 1 April 2021 its recommendation to financial organisations related to restructuring of loans to individuals and SMEs confronted with an epidemic-induced deterioration in their financial position.**

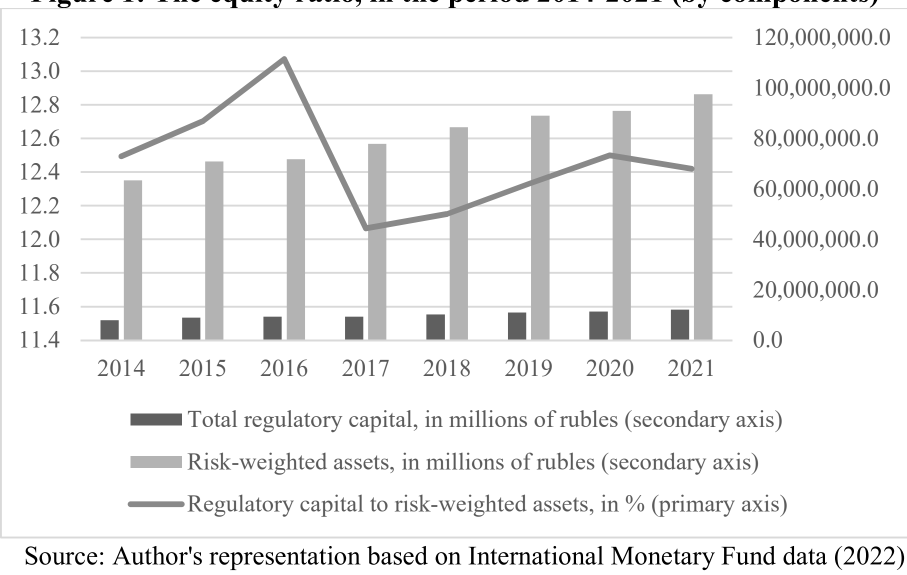
Source: author's summary based on Bank of Russia press releases (2020).

The four successive cuts in the key rate in 2020 (Table 1), totalling 200 basis points, helped reduce funding costs and facilitate lending. Also, in September 2020, the banking sector had achieved a significant stability space in the form of the capital buffer of 5.5 trillion rubles, as well as the macroprudential capital buffer of 0.6 trillion rubles. Both the level of capitalization and that of profitability allowed the banking sector to restructure and provide loans the population and companies. In December 2020, the value of restructured loans of households and companies amounted to more than 6.5 trillion rubles (Bank of Russia, 2020).

3 Assessing the financial stability of the Russian banking system during the COVID-19 crisis

Russian banks faced the challenges of the pandemic from a position of strength. The banking system held an adequate level of capital and liquidity in the years leading up to this crisis (Figure 1), but also of capital buffers for systemic banks and anti-cyclical capital. At the same time, profitability reached its pre-crisis peak, so the decline in 2020 was offset by a rebound in 2021 (Figure 2 and Figure 3). The high level of capitalization allowed banks to form sufficient provisions for loan losses, reducing the risk generated by non-performing loans.
Considering the wide range of stabilization measures adopted by central bank, the equity ratio maintained its upward trend during 2020, reaching the level of 12.5% (Figure 1). This was well above the level established by the prudential requirements of the central bank, of 8%.

Figure 1: The equity ratio, in the period 2014-2021 (by components)

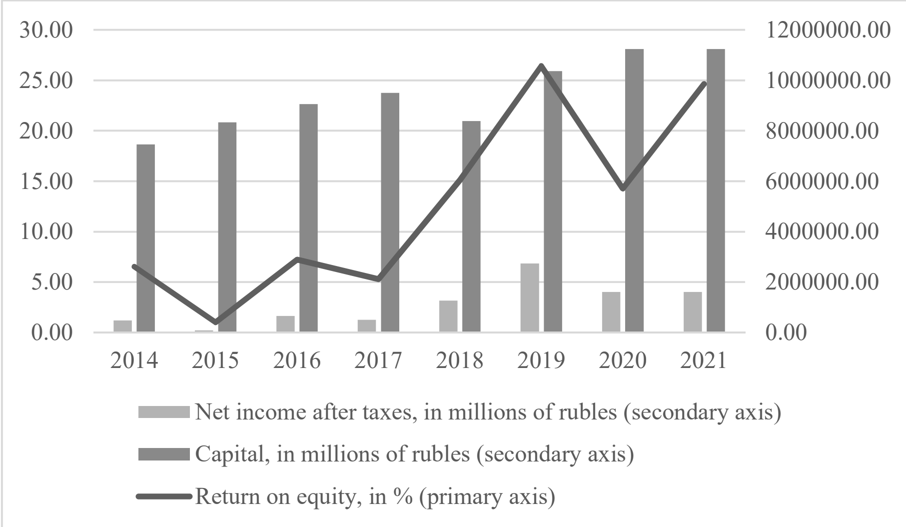


Source: Author's representation based on International Monetary Fund data (2022).

At the same time, the COVID-19 pandemic negatively affected the bank profitability, as the net income after taxes dropped by 41% in 2020. Return on equity (ROE) fell almost twofold, from 26.4% in 2019 to 14.3%

in 2020 (Figure 2). At the same time, due to the economic recovery of the Russian Federation in 2021, banks recorded an increase in ROE, reaching almost the record pre-pandemic level.

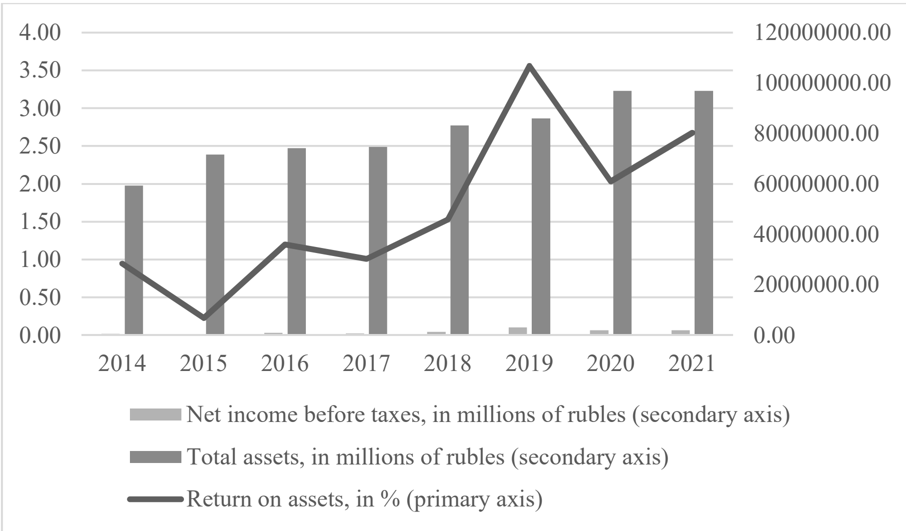
Figure 2: Return on equity, in the period 2014-2021 (by components)



Source: Author's representation based on International Monetary Fund data (2022).

The return on assets (ROA) followed an evolution close to that of ROE, decreasing in 2020 to the level of 2.03%, as the net income before taxes dropped by 35%. Although the economic downturn of 2020 affected the profits generated by banking assets, the economic recovery in 2021 determined a rise in assets profitability to 2.7% (Figure 3).

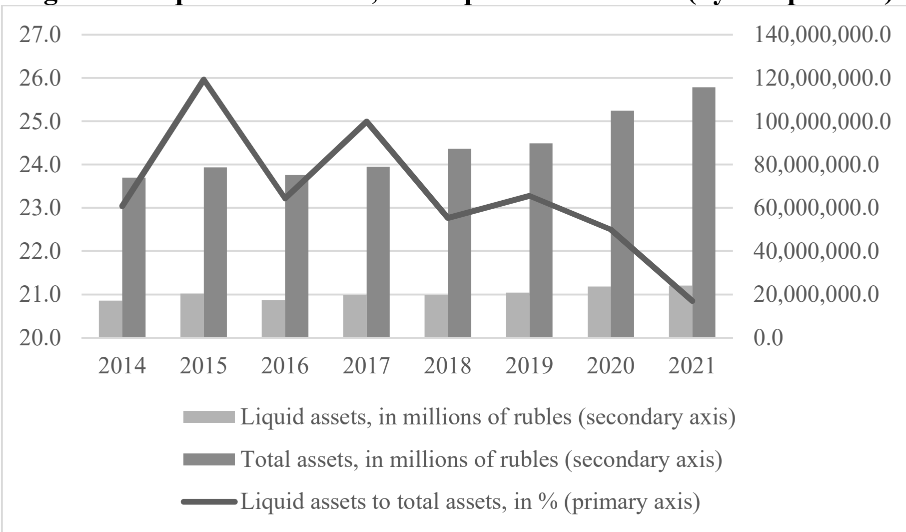
Figure 3: Return on assets, in the period 2014-2021 (by components)



Source: Author's representation based on International Monetary Fund data (2022).

Another important indicator that reflects the resilience of the banking system to crises and episodes of withdrawal of deposits is the ratio of liquid assets. It determines the ability of banks to meet their short-term financial obligations, i.e., cash demands. Since banks operate with resources drawn from other entities, their ability to meet repayment demands on these resources is paramount and must be carefully analysed. Banking institutions that have a ratio of liquid assets below the 20% threshold are inclined to face liquidity shortfalls and could potentially experience difficulties in the event of a liquidity crisis and deposit withdrawals (Monahov, 2020). The pandemic determined a decline in the ratio of liquid assets, both in 2020 and 2021, to 22.5% and, respectively, to 20.8% (Figure 4). Although it contracted, these levels were still above the threshold, reflecting a high level of resilience of the banking system to possible withdrawals of deposits.

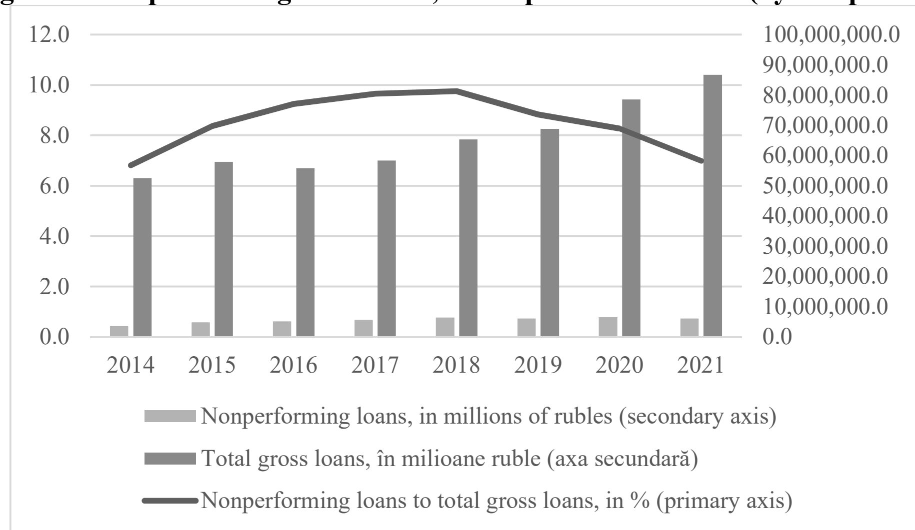
Figure 4: Liquid assets ratio, in the period 2014-2021 (by components)



Source: Author's representation based on International Monetary Fund data (2022).

Although the financial situation of debtors worsened during the pandemic as a result of lockdowns, the measures adopted by the Bank of Russia, namely loans restructuring, easing of prudential requirements related to restructured loans, postponing payments on mortgage loans for up to 6 months etc., helped to avoid a credit crunch and a deterioration of assets quality. The IMF data (2022) shows that the rate of non-performing loans decreased during the pandemic, from 8.8% in 2019 to 8.3% in 2021 (Figure 5). Moreover, it continued to fall in 2021, reaching the level of only 7%.

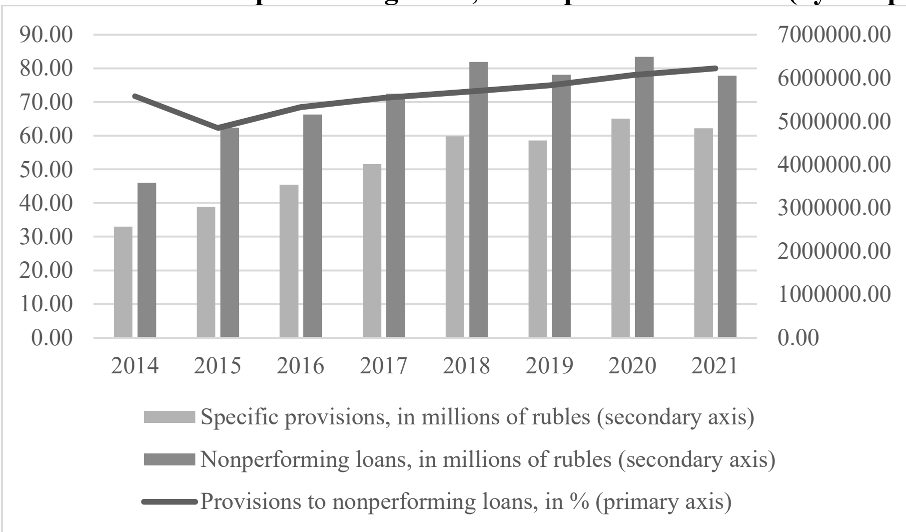
Figure 5: Nonperforming loans ratio, in the period 2014-2021 (by components)



Source: Author's representation based on International Monetary Fund data (2022).

At the same time, Russian banks managed to create solid provisions to non-performing loans during pre-pandemic years, as a result of the adequate level of capitalization. In the context of COVID-19 crisis, they increased slightly, from 74.9% in 2019 to 78.02% in 2020, reflecting a significant credit risk cushion (Figure 6). More than that, banks succeeded to maintain this upward trend in 2021.

Figure 6: Provisions to nonperforming loans, in the period 2014-2021 (by components)



Source: Author's representation based on International Monetary Fund data (2022).

After the shock of the pandemic crisis, the Russian banking system faced new challenges under the conditions of the Russian Federation's invasion of Ukraine. In the first quarter of 2022, as a consequence of the largest number of financial and trade sanctions globally imposed by Western countries on a state, Russian banks faced massive withdrawals of deposits, rising funding costs and declining lending activity (Bank of Russia, 2022a). The uncertainty related to the extent of the effects of Western sanctions on the Russian economy, but also the severe collapse of the ruble, generated panic among the population and a severe liquidity crisis, which peaked in March 2022. The amount of funds withdrawn from current and deposit accounts since the beginning of the year reached the level of 7,005 billion rubles, i.e., 20% of the total amount of resources attracted from the population (Bank of Russia, 2022b). However, the situation has stabilized, starting from June, as the effects of the Bank of Russia and the government's measures started to have a visible effect (Bank of Russia, 2022c). Along with the key rate cutting, an upward trend in the demand for loans from the population can be observed. In addition, the high level of capitalization and the relaxation of capital buffer requirements allowed banks to absorb loan losses. However, the sanctions imposed by Western countries most likely would have a negative long-term effect on the Russian economy, with the risk of damaging the banking system.

4 Conclusions

In conclusion, in order to avoid disruptions in the banking activity and to support lending, the Bank of Russia adopted measures aimed at stabilizing the financial system, initiating an extensive liquidity injection into the banking system, providing new lending facilities to banks, temporarily relaxing prudential requirements, etc. In this context, the banking system has managed to remain sufficiently capitalized so that it could cover banking losses and risks. Also, the banks recorded a high level of resilience to possible deposit withdrawals, as liquid assets ratio stayed above the minimum liquidity requirement during 2020-2021. However, the profitability of the Russian banking sector suffered in the context of the COVID-19 crisis, as the bank net income fell. In addition, although the financial situation of debtors worsened during the pandemic as a result of lockdowns, the measures adopted by the Bank of Russia, namely loans restructuring, easing of prudential requirements related to restructured loans, postponing payments on mortgage loans for up to 6 months etc., helped to avoid a credit crunch and a deterioration of assets quality. At the same time, Russian banks managed to create solid provisions for non-performing loans, as a result of the adequate level of capitalization. In 2022, the financial system of the Russian Federation was severely affected by international sanctions, imposed as a result of the Russian invasion in Ukraine. In this context, the central bank and the executive authorities adopted significant measures to reduce the volatility on the stock exchange and the foreign exchange market, but also to ensure the stability of the banking system. To limit the devaluation of the national currency, with a significant part of the central bank's international foreign exchange reserves frozen, the central bank carried out unprecedented liquidity and refinancing operations, while the executive authorities adopted a series of capital restrictions. In addition, to stabilize the stock exchange market, it suspended trading on the stock exchange market for several weeks, while to increase the banking system resilience it relaxed prudential supervision.

References:

[1] Bank of Russia (2020). Bank of Russia retains national countercyclical capital buffer rate and risk-weight add-ons, Press release, 18 December 2020, http://www.cbr.ru/eng/press/pr/?file=18122020_143000eng_pp24122020_091954.htm#highlight=pandemic

[2] Bank of Russia (2022a). Financial Stability Review Q4 2021-Q1 2022, https://www.cbr.ru/Collection/Collection/File/41036/OFS_22-1_e.pdf

[3] Bank of Russia (2022b). On the development of the banking sector of the Russian Federation in September 2022, http://www.cbr.ru/Collection/Collection/File/43415/razv_bs_22_09.pdf

[4] Bank of Russia (2022c). On the development of the banking sector of the Russian Federation in August 2022, http://www.cbr.ru/Collection/Collection/File/42340/razv_bs_22_08.pdf

[5] IMF (2020). Russian Federation: Staff Concluding Statement of the 2020 Article IV Mission, https://www.imf.org/en/News/Articles/2020/11/23/mcs112420-russia-staff-concluding-statement-of-the-2020-article-iv-mission

[6] IMF (2022). World Economic Outlook: April 2022, https://www.imf.org/en/Publications/WEO/weo-/2022/April/

[7] IMF (2022b). Financial soundness indicators, https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA

[8] Monahov, A. (2020). Stress-testing a shock to remittances in a post-COVID world - what impact on liquidity?, https://www.researchgate.net/publication/342666071_Stress-testing_a_shock_to_remittances_in_a_post-COVID_world_-_what_impact_on_liquidity