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**TRENDS AND OUTLOOKS**

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The review “Russian Economy. Trends and Outlooks” has been published by the Gaidar Institute since 1991. This is the 42th issue. This publication provides a detailed analysis of main trends in Russian economy, global trends in social and economic development. The paper contains 6 big sections that highlight different aspects of Russia’s economic development, which allow to monitor all angles of ongoing events over a prolonged period: global economic and political challenges and national responses, economic growth and economic crisis; the monetary and budget spheres; financial markets and institutions; the real sector; social sphere; institutional changes. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts confirming the conclusions.

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### 3.3. Russian Banking Sector in 2020<sup>1</sup>

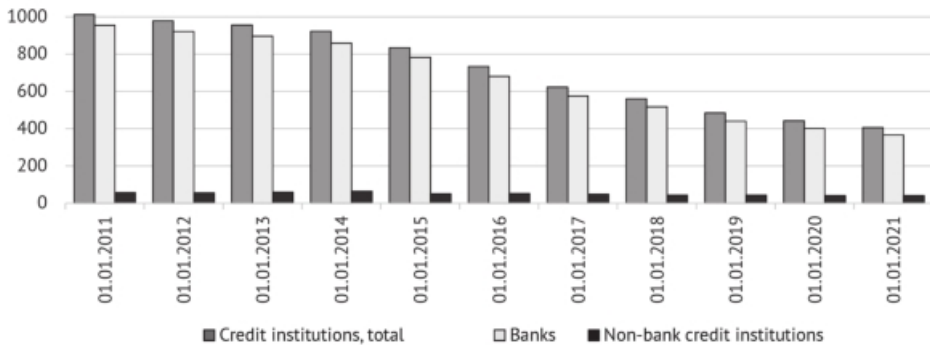
#### 3.3.1. Main Indexes and Financial Banking Performance

As of end 2020, there were 406 credit institutions in Russia against 442 a year earlier. Over the year, the number of operating credit institutions decreased by 36 (in 2019 – by 42). At the end of the year, the number of banks with a universal license came to 248 (at the beginning of the year – 266), with a basic one - 118 (at the beginning of the year – 136). In 2020, the number of non-bank credit institutions did not change and amounted to 40 (*Fig. 65*). At the end of the year, there were 379 credit institutions subject to liquidation procedures.

The reduction in the total number of bank credit institutions is accompanied by the consolidation of the banking sector – in 2020, there was an increase in assets, equity and profits. Despite the pandemic, the total assets of credit institutions in the past year increased by 16.5% (in 2019 – 2.7%), the banks' own funds – by 11.3% (in 2019 – by 7.6%).

Contraction of the total number of banking credit institutions comes with the banking sector consolidation – in 2020, we observed growth of assets, own assets, and profit. Despite the pandemic, total assets of credit institutions gained 16.5% last year (2.7% in 2019), own assets of banks gained 11.3% (7.6% in 2019).

<sup>1</sup> This section was written by: *Zubov S.*, Candidate of Economic Sciences, Docent, Senior Researcher, Structural Research Department, IAES RANEPА.



*Fig. 65.* The movement of the number of credit institutions during recent 10 years

Source: Bank of Russia.

As of January 1, 2021, 291 banks recorded profit worth Rb1.64 trillion, and losses of 75 banks were to the tune of Rb33.3 trillion. Thus, the number of loss-making banks rose to 20.5% against 15.6% in 2019.

In general, the Russian banking sector was prepared for the current crisis, largely due to the RF Central Bank's stabilization policy pursued in recent years. Maintaining a high level of liquidity, ending the activities of insolvent banks, as well as increasing the requirements for the quality of banking products and services through the implementation of the Basel Standards has made it possible to increase the stability of the domestic banking system.

That being said, in the context of high volatility of the financial markets and unpredictability of the pandemic fallout, Russian credit institutions have been forced to adjust their market policy of the previous years which led to a notable reduction in profitability of the banking system compared to the previous year.

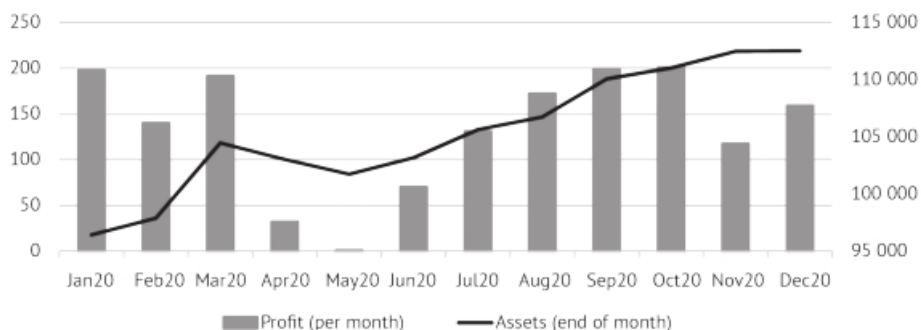
Despite the unprecedented rise in the banking sector's assets, the total net profit has significantly decreased relative to 2019. As of January 1, 2021, it amounted to Rb1,608.1 bn, which is 6.2% lower than a year ago (as of January 1, 2020, the profit of the banking sector amounted to Rb1,715.1 bn)

The profitability of the banking business has significantly decreased compared to the previous year with the decline in the rate of profit growth and synchronized acceleration of the growth of assets and capital. The ROA<sub>1</sub> as of January 1, 2021 constituted 1.4% (1.9% a year ago), the ROE<sub>2</sub> stood at 15.1% (19.1% a year ago).

Interest rate decline is the principal reason for the relative decrease in profit margins and profitability. This fact was especially noticeable in Q2 2020, when the policy of the RF Central Bank contributed to a reduction in interest rates in the retail and corporate lending market, while relatively expensive funding for medium and long-term contributions and deposits remained in bank portfolios (*Fig. 66*), at the same time, in the face of competition many banks offered

1 ROA (Return on assets) – return on assets, ratio of net profit to total assets of a credit institution.

2 ROE (Return on equity) – return on equity, ratio of net profit to equity of a credit institution.



*Fig. 66.* Dynamic of profit and assets of the banking sector in 2020 (Rb bn)

*Source:* statistical bulletin of the Bank of Russia 2020–2021

increased rates on savings accounts to replenish their resource base and retain customers.

Another factor related to the reduction in bank profits was the growth of provisions for potential losses on loans and other active operations in the context of market instability and the expected decline in creditors' solvency. Despite the regulatory easing by the RF Central Bank, banks continued to ramp up spending on creation of provisions along with the growth of lending volumes. Thus, for instance, according to IFRS for 9 months of 2020, the Sberbank net interest income declined by 13.5% compared to the previous year taking into account the created reserve,<sup>1</sup> the respective indicator of Alfa Bank decreased by 16,2%,<sup>2</sup> and reduction of VTB constituted 23,8%.<sup>3</sup>

High volatility of the foreign currency market and ruble's depreciation have contributed to maintenance of a positive financial performance of the banking sector. One of the main factors behind the growth of bank income during the pandemic was the net income from operations with foreign currency and precious metals and their revaluation. For a year, this index gained 413.6% (it shed 31.3% over 2019).

Banks continue to master technologies to optimize business processes in order to reduce administrative and management costs. In 2020, significant changes were recorded in the dynamic of costs associated with supporting the activities of credit institutions. This indicator includes staff costs; operations with fixed assets; organizational and administrative expenses; as well as other types of non-operational expenses (legal costs, write-off of shortages, charity, etc.). At the year-end, this type of expenses decreased by merely 1.4% against the corresponding index of the previous year (it gained 8.1% in 2019). To the greatest extent, the reduction affected organizational and management costs (by 13.4%) and other

1 URL: [https://www.sberbank.com/common/img/uploaded/files/info/ifrs2020/20/20209mruiifs9m\\_presentation.pdf](https://www.sberbank.com/common/img/uploaded/files/info/ifrs2020/20/20209mruiifs9m_presentation.pdf)

2 URL: [https://alfabank.ru/f/3/about/annual\\_report/msfo/MSFO\\_20\\_3.pdf](https://alfabank.ru/f/3/about/annual_report/msfo/MSFO_20_3.pdf)

3 URL: <https://www.vtb.ru/-/media/Files/aktsioneram-i-investoram/finansovaya-informatsiya/msfo/ezhekvaralnye/2020/rus/3q/3q2020-ifrs-results-rus.pdf>

expenses (by 15.5). Thus, cost management aimed at improving operational efficacy is becoming one of the ways to maintain a high level of bank profitability amid low interest rates. The indicator of administrative and management costs vs operating income (cost-to-income ratio, CIR) continues to decline, and as a whole, it should be less than 40% in the banking sector at the year -end (the CIR of Sberbank decreased to 27.2% in the mid of 2020).<sup>1</sup> This factor proves a rather high operational efficiency of Russian banks compared to European banks: in France, the CIR is above 60%, in Germany it is above 70%.

As it was mentioned in our previous publications<sup>2</sup>, banks are forced to shift their focus towards increasing operations that generate fee income in the context of aggravated credit risks, as well as measures by the Central Bank aimed at lowering market interest rates (lowering the key rate). The trend reversed in Q3, and income growth resumed after a drop in fee income in H1 of 2020: thus, the most significant growth was recorded in income obtained from the following operations trust administration of property (up by 117.5% compared to the corresponding index as of end of 2019), provision of intermediary services under brokerage and similar agreements (up by 28.1%), issue of bank guarantees and sureties (an increase by 29.0%). The total increase in fee income amounted to 9.7% for 3 quarters compared to 13.8% for the same period in the previous year.

The gradual reorientation of banks to commission transactions led to a situation that the net fee income of banks specializing in settlement and intermediary operations exceeded the level of net interest income based on results of three quarters of 2020, taking into account the created reserve.

- Several factors determine the maintenance of a stable growth in fee income:
- increasing the share of non-cash payments in settlements while maintaining sufficiently high acquiring rates<sup>3</sup>;
  - spreading the remote banking system (mobile wallet, telephone SMS-banking, electronic document flow systems, etc.);
  - growing demand for brokerage services (transactions with financial assets on exchange and over-the-counter Russian and international markets).

In the near future, one should not expect a significant increase in the marginality of the banking sector. Interest rates on both loans and deposits will remain at a consistently low level in the absence of macroeconomic and political shocks. The quality of the loan portfolio will have a decisive influence on the financial results, i.e. the level of overdue debt, as well as the need for additional provisioning after the revocation of the Central Bank easing measures. Banks are likely to seek compensation for the decline in interest income by increasing operations that generate fee income. This process can accelerate with the intensive penetration of banks into non-banking services, further development of the remote service system, promotion of marketplace services for individuals and legal entities.

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1 URL: [https://www.sberbank.ru/en/press\\_center/all/article?newsID=f88d5580-c1dd-4fa7-9067-935f189abd09&blockID=1539&regionID=77&lang=en&type=NEWS](https://www.sberbank.ru/en/press_center/all/article?newsID=f88d5580-c1dd-4fa7-9067-935f189abd09&blockID=1539&regionID=77&lang=en&type=NEWS)

2 URL: <https://www.iep.ru/ru/doc/35607/finansovye-rezultaty-rossiyskikh-bankov-v-yanvare-avguste-2020-goda.pdf>

3 This type of service includes connection, installation and maintenance of payment terminals, Internet and mobile acquiring, connection of ApplePay and GooglePay, etc.

### 3.3.2. Corporate lending

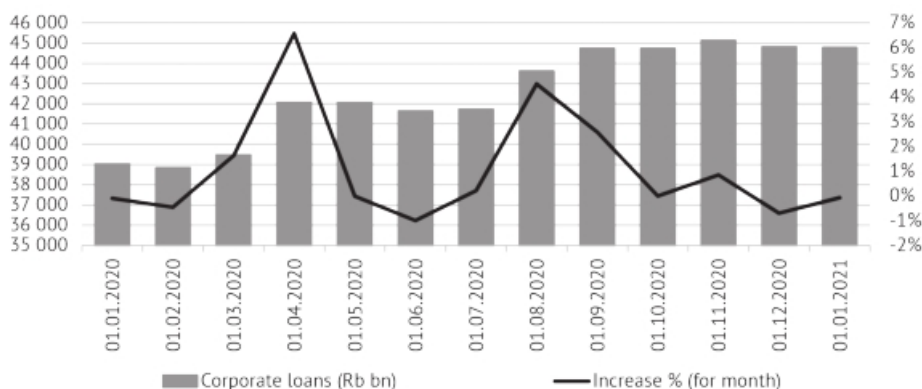
After the introduction of restrictive measures in connection with the spread of the coronavirus infection, the Central Bank of the Russian Federation implemented a set of regulatory measures that helped to reduce banks' spending on reserve formation and stimulate soft lending. The actions of the Bank of Russia, as well as the margin of safety of the banking system in terms of liquidity and capital provision, made it possible to avoid the credit shocks of 2008 and 2014 and to ramp up the volume of corporate lending.

The spike in activity on the corporate lending market during the pandemic is due to three main factors:

- the need to compensate for the decline in cash flows and possible unforeseen expenses of companies in the context of stagnant business activity;
- currency revaluation due to ruble's devaluation;
- a set of regulatory measures aimed at supporting targeted lending by banks to corporate clients.

As of January 1, 2021, the total corporate debt<sup>1</sup> before Russian banks was worth Rb44.8 trillion. The growth in 2020 totaled Rb5.8 trillion, or 14.8%. Thus, growth rates of corporate lending significantly exceed last year indexes (*Fig. 67*). A year earlier, the corporate loan portfolio of Russian banks for the same period increased by merely Rb1 trillion, or by 2.6%.

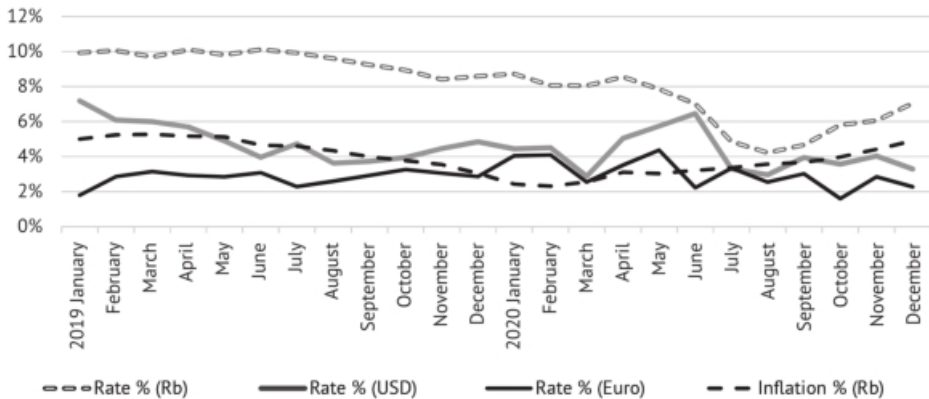
From the start of the year, the foreign exchange portfolio gained 11.4% and totaled Rb33.1 trillion or 74.0% of the total amount of corporate debt. A year ago, the ruble portfolio gained 8.2% and its share in the total credit portfolio came to 76.3%.



*Fig. 67. Corporate lending dynamic in 2020*

Source: Bank of Russia. URL: [https://cbr.ru/banking\\_sector/statistics/](https://cbr.ru/banking_sector/statistics/).

<sup>1</sup> Including non-financial, financial institutions (other than banks), individual entrepreneurs and enterprises belonging to non-residents (other than banks).



*Fig. 68.* Rates on corporate lending market (from 6 months to a year)

*Source:* Bank of Russia. URL: [https://cbr.ru/statistics/bank\\_sector/int\\_rat/](https://cbr.ru/statistics/bank_sector/int_rat/).

The foreign exchange portfolio in the past year grew primarily owing to changes in the ruble exchange rate, an increase of 25.5% as of January 1, 2021. In 2019, due to the strengthening of the ruble, this index dropped by 12.9%.

The term structure of the loan portfolio has undergone some changes. In the ruble portfolio, the share of short-term loans (up to 1 year, including loans on call) at the beginning of 2020 was approximately 75.8% of the total volume, in October this index fell to 66.2%. The structure of the foreign exchange portfolio demonstrated opposite trend: the share of short-term loans denominated in dollars went up from 69.6% at the beginning of 2020 to 91.1% in October.

Short-term pro-inflation risks at the outbreak of the pandemic had almost no negative impact on the cost of lending in the ruble segment. A slight increase was recorded in April during the period of self-isolation, however, in the following months, as inflation expectations stabilized and as a result of the Central Bank key rate cut, interest rates went down steadily, hitting an all-time low. By the end of the year, there was a slight uptick. In the foreign exchange segment, rates were subject to fluctuations due to the instability of the foreign exchange market, however, a downward trend in rates also took place (*Fig. 68*).

The corporate loans structure has not changed significantly. Manufacturing industries are the leaders in terms of debt (22.2% of the total loan portfolio of Russian banks), the share of the agricultural sector accounts for 6.2%, mining and quarrying sector accounts for 5.9%. Real estate transactions account for 17.1%, wholesale and retail trade - 9.8%, agriculture - 6.2%, mining and quarrying sector - 5.9%. At end-2020, the above-average rates were recorded in the extractive sector (up by 33.9% since the beginning of the year), as well as in the field of real estate transactions (21.0%). The decrease was recorded in the wholesale and retail trade (-9.8%).

Despite the measures taken by the Central Bank to support enterprises in terms of soft lending to vulnerable industries, many areas of activity have undergone



serious difficulties in attracting bank loans and were forced to reduce borrowing. As of January 1, 2021, 26 OKVED-2 codes (32.1% of all activities) exhibited a decrease in bank loan debt. The most substantial drop was recorded in the OKVED-2 codes “65 - Insurance, reinsurance, activities of non-state pension funds, except for mandatory social security” (a decrease of 82.1% relative to the debt at the beginning of the year), “53-Postal and courier activities” (a decrease of 62.4%), “74 - Professional scientific and technical and other activities” (a decrease of 55.4%).

The highest growth rates of accounts payable were recorded in the codes “09 - Provision of services in the field of mining” (an increase of 284.7%), “78 - Employment and recruitment activities” (an increase of 236.8%), “90 - Creative activities, activities in the field of art and entertainment” (an increase of 205.3%).

Under the circumstances, it is difficult to give an adequate assessment of the quality of the loan portfolio. As of January 1, 2021, the level of past-due debt stood at 7.1% of the total volume of lending. A year ago, this index also stood at 7.1%, however, it is impossible to conclude that the quality of the loan portfolio is stable, such stability is largely ensured by the introduction of a moratorium on bankruptcy, by the process of restructuring credit debt and provision of credit holidays. According to information<sup>1</sup> obtained from 33 credit institutions, in the period from March 20, 2020 to January 1, 2021, the volume of restructured loan debt (including SME entities in the amount of Rb 853.5 bn) exceeded Rb 6.2 trillion, or 13.9% of the total bank portfolio.

The current financial crisis brought about by the pandemic has led to abnormal growth in banks' corporate portfolios. Overall, the debt burden on the Russian business is quite in harmony with that of emerging market countries. However, in Russia a small number of large borrowers which are customers of major banks account for a larger portion of corporate debt. The high concentration of corporate debts may trigger off a system risk in the banking sector, so, it would be advisable for banks to revise and adopt more prudent requirements to financial dimensions and risk-based models. In the coming months, we should expect the possible realization of credit risks, and the timely identification of troubled borrowers and the implementation of a set of measures to compensate for losses become an important task for bank risk management.

At the initial stage of the pandemic, the Central Bank developed measures to support enterprises in potentially vulnerable industries, medical enterprises, and focused on supporting small and medium-sized businesses.

In March, with the introduction of quarantine measures, the Bank of Russia expanded the special program for refinancing SMEs, setting the program limit at Rb500 bn and cutting the rate from 6 to 4%, with allocation of Rb150 bn for lending to SMEs in order to support employment. Loans under this mechanism are provided for a period of 1 year at a rate of 4%. For banks with a high credit rating, loans are provided without collateral.

As an additional measure, the interest rate under the existing refinancing mechanism under the guarantee of JSC “SME Corporation” was reduced from 6 to

<sup>1</sup> URL: [https://cbr.ru/Collection/Collection/File/31944/drknb\\_15\\_2021.pdf](https://cbr.ru/Collection/Collection/File/31944/drknb_15_2021.pdf)

4%, and industry restrictions were lifted. At the same time, the final rate for the borrower should not exceed 8.5%.

From April 27, 2020, the interest rate on the Bank of Russia loans aimed at supporting lending to SMEs, including for urgent needs to support and maintain employment, was reduced from 4 to 3.5%, and from June 22, 2020 – to 2.5% per annum.

It was decided that the assessment of the borrower’s financial situation and/or the quality of debt service on loans restructured in connection with the pandemic (enterprises of vulnerable industries) should not be downgraded. Subsequently, these regulatory easing was extended to enterprises in all industries, provided that the loans granted were classified as of March 1, 2020, no worse than in the II quality category. Banks are given the right to form reserves for corporate loans restructured before September 30, 2020, until April 1, 2021.

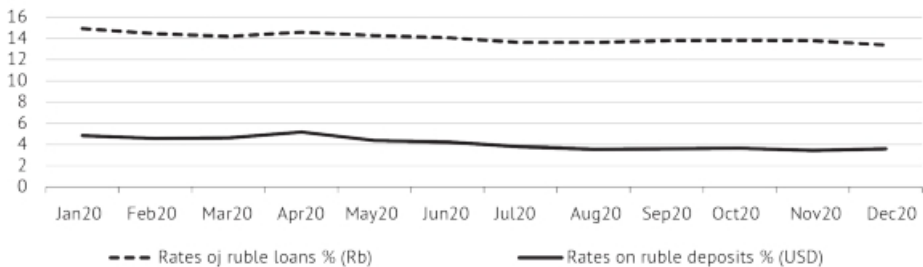
### 3.3.3. Retail lending

The total retail loan debt gained 13.6% and as of January 1, 2021 amounted to Rb20.0 trillion. In 2019, the increase was slightly higher – 18.5%. The ruble portfolio grew by 13.6% (18.8% in 2019), the foreign exchange portfolio in ruble equivalent grew by 13.9% (25.4% recorded in 2019).

In the consumer and automobile lending sector, the negative impact of the crisis was very pronounced, however, despite the fall in consumer demand, an increase of 8.8% and 7.9% was recorded, respectively. The most significant decline in volumes was observed in the unsecured consumer lending market, for which banks continued maintaining high margins despite the easing of the RF Central Bank monetary policy. In general, the interest rates demonstrated a steady downward trend during the year (*Fig. 69*).

In the wake of the pandemic the Bank of Russia measures were designed to protect the interests:

- citizens affected by the pandemic and unable to service the debt;
- citizens who faced a reduction in incomes following the imposition of self-isolation measures;



*Fig. 69.* Interest rates dynamic on operations with the population (loans and deposits from 6 months to 1 year) in 2020

Source: Bank of Russia. URL: [https://cbr.ru/statistics/bank\\_sector/int\\_rat/](https://cbr.ru/statistics/bank_sector/int_rat/).

- credit institutions on the back of raised credit risks.

The central bank has adopted the following measures:

- when the borrower confirms coronavirus infection, recommend that banks, microfinance organizations and consumer credit cooperatives take measures to defer payments on the loan. Such measures may include various restructuring schemes, deferrals on repayment of the loan body and interest, credit holidays, as well as the abolition of fines and penalties on loans;
- borrowers-individuals who find themselves in a difficult situation, are given the opportunity to take advantage of credit holidays, i.e. to postpone payments on loans for up to 6 months from April 1 to October 1, 2020. According to the Bank of Russia recommendations, the borrower can send a request for repayment holiday, and the bank is obliged to consider it within five days. In this regard, the Bank of Russia sent recommendations on the procedure for calculating the decrease in the borrower's income during the pandemic, and also recommended that lenders restructure loans using their own methods.

In order to support lending, in April the Central Bank of the Russian Federation dissolved the accumulated macroprudential capital buffer and reduced the allowances for newly granted loans.

In order for lenders to develop uniform approaches to informing citizens about the terms and conditions of the credit holidays, to differentiate the state program from their own restructuring programs, and to prevent violations of the borrowers' rights, the Bank of Russia sent an Information Letter to lenders dated 15.05.2020 No. IN-06-59/89. It recommends familiarizing borrowers with all existing restructuring options, as well as with the procedure for calculating interest and returning to the payment schedule, all the rules and features of registration of various types of credit holidays, deferrals and benefits. This gave the borrower an opportunity to assess the difference between alternative ways of restructuring and choose the best option. In the event of a refusal to satisfy the borrower's claims for restructuring, creditors were advised to inform the debtor of the reasons for such a decision.

In order to reduce the negative fallout of the ruble's weakening and given possible fluctuations in the exchange rate, the Bank of Russia allowed the restructuring of the debt with respect to change the loan currency from foreign to Russian until September 30, 2020 timeframe, if the borrower applied to the bank accordingly.

The deterioration of the financial situation of most borrowers negatively affected their credit history and their ability to borrow in the future. In this regard, the Central Bank of the Russian Federation recommended that credit institutions and credit bureaus do not downgrade the assessment of the borrower's creditworthiness if the reason for the debt restructuring was related to the spread of coronavirus infection. This regulation applied to all types of restructuring, both in accordance with the recommendations of the Central Bank of the Russian Federation, and within the framework of credit institutions' own programs.

In mid-April, after the extension of the self-isolation regime, the Bank of Russia enabled banks not to increase reserves for loans to borrowers whose financial situation deteriorated due to the pandemic, as well as for all restructured loans. This decision has reduced the burden on the capital of credit institutions. The Bank of Russia temporarily entitled the banks to postpone the provision of additional reserves, expecting that most of the borrowers will be able to return to normal debt service, and those restructurings that will prove problematic will be gradually reserved by the banks.

Overdue debt increased by 22.0% against 0.5% in 2019 and reached Rb932.4 bn, but its share in the loan portfolio has increased considerably since the start of the year – by 0.4% to 4.7% (as of 01.01.2020, the share of overdue debt stood at 4.3%).

Loan reserves have grown markedly, since the beginning of the year their growth gained 15.3% against 2.4% in the previous year, which demonstrates a deterioration in the financial situation of some borrowers' expectations for the near future.

By the end of 2020, the situation in the retail banking sector had significantly improved compared to the beginning of the pandemic. At the same time, the economic downturn and the reduction in households' real incomes lead to the realization of credit risks. The regulatory easing implemented by the Central Bank of the Russian Federation contributed to the restructuring of loans, enabled some borrowers to restore their financial situation, and also ensured the stability of bank deposits. The way out of the easing largely depends on epidemiological factors and will be implemented over a long timeframe. However, the gradual elimination of temporary measures is necessary for an adequate risk assessment and restoration of financial stability.

#### 3.3.4. Mortgage lending

Despite the coronavirus pandemic induced decline in business activity, the Russian housing mortgage lending (HML) market reported record levels in 2020. In total, over the past year, credit institutions originated 1.71 million mortgage loans, up by 34.9% compared to 2019 with 1.27 million loans, and up by 16.4% against relatively record high 2018 with 1.47 million loans. The volume of loans issued in the past year hit Rb4.30 trillion, up by 50.8% on 2019, and up by 42.6% on 2018).

By the end of 2020, the total amount of hypothecary debt exceeded Rb9 trillion. The annual loan debt growth hit 21.4% against 17.1% in 2019, and 23.9% in 2018. The total share of mortgage loans constituted 45.2% of the total bank retail loan portfolio. Thus, the share of mortgage loans in the total portfolio went up within a year, it stood at 42.3% at the beginning of 2020.

Refinancing of credit remains an important factor behind the mortgage market growth. At 2020 year-end, it totaled 13.7% of the overall value of mortgage lending (in 2019, refinancing amounted to 6.8%).

Mortgage lending remains the best retail credit segment, overdue debt is at a consistently low level: at the end of the year, the share of overdue debt on

mortgage loans was merely 0.8% (0.9% at the end of 2019, and 1.0% at the end of 2018 – 1.0%), meanwhile the outstanding debt comes to 7.8% in other segments of retail ending. The share of non-performing loans (NPL 90+) was at 1.4%, staying unchanged over the year.

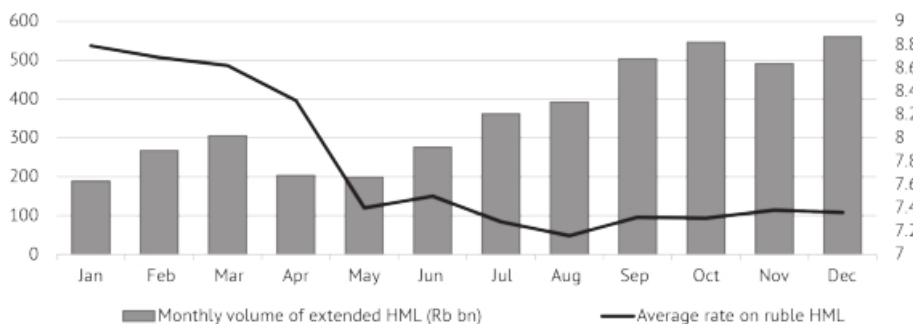
Mortgage loans denominated in foreign currency are in little demand. The value of debt denominated in foreign currency stood at Rb16.1 bn at the year-end or around 0.2% of total amount of housing mortgage debt dropping by 24.6% within a year. The quality of foreign currency credit portfolio is way below the ruble denominated loans: the share of outstanding debt came to 39.9% at the end of 2020.

The average loan maturity upward trend remains unchanged - in December 2020, the weighted average loan maturity constituted 225.1 months, up by 6.7 months or by 3.0% over year.

The launch of the soft mortgage loan program “6.5%” and reduction in the market interest rates (*Fig. 70*) are behind the peak indicators of the mortgage market in 2020. The average interest rate on the ruble loans dropped to 7.36% against 9.68% year earlier. In October-November last year, mortgage deals in the foreign currency segment were at 5% interest rate.

Credit rates on the primary market (new-built housing) remain around 2 p.p. below those seen on the secondary market (secondary housing) owing to the implementation of a number of soft mortgage loan programs (soft mortgage loan program 6.5%, household mortgage, Far-Eastern mortgage). Nevertheless, the high housing demand unfolding on the secondary residential market is primarily behind the mortgage lending growth. Out of the total number of issued housing mortgage loans, 71.7% account for the purchase of new-built housing.

Originally, the state soft mortgage loan program was to be effective through November 2020, however it was extended in late October 2020 through July 1, 2021.



*Fig. 70. Monthly lending volumes and interest rates dynamic on the housing mortgage lending market in 2020*

*Source:* Information on housing mortgage lending market in Russia. Information Bulletin No. 8. Statistical Indexes January 01.2018 – January 01.2021.

1 In contrast to the amount of overdue debt, this index takes into account the total volume of loans for which payments have not been made for over 90+ days.

Mortgage lending was less exposed to the pandemic-induced shocks (3.1% of past due debt was restructured) including thanks to the timely kick start of the state program to subsidize the interest rate to 6.5%. Already in Q3 2020, mortgages became a driver of retail lending growth, which was also facilitated by the Bank of Russia's transition to the monetary policy easing.

The reduction in mortgage rates due to the Bank of Russia monetary easing coupled with the launch of soft mortgage loan programs have boosted demand for housing and mortgage. This being said, the unprecedented growth in mortgage lending has not created a housing bubble, the mortgage lending remains the best segment of the retail lending market.

Despite the implementation of stimulus measures, the completion of the transition of housing construction financing to a new model that provides a full state guarantee for citizens who invest their money in housing under construction was the main event of 2020. In December 2020, the volume of housing built using escrow accounts exceeded the volume of housing built under the old rules. The transition of housing construction to project financing has allowed avoiding the issue of hoodwinked investors even in the most difficult months of self-isolation, when construction and sales of housing in many regions of Russia have actually stopped. As a result, since the beginning of the reform, there have never been any problems with the use of escrow accounts. The new construction financing scheme has solved the problem of unfinished construction, which used to be one of the main and painful problems in the field of housing construction.

In early November 2020, Federal Law No. 368-FZ of November 09, 2020 "On Amendments to Parts One and Two of the Tax Code of the Russian Federation" came into force, which introduced numerous changes to the legislation on taxes and fees. This law regulated the most important issue of taxation for developers of cost sharing construction – the possibility of recognizing funds in escrow accounts as targeted financing. This will allow most developers to safely exclude from the tax base the funds received in escrow accounts, and tax only the difference – the excess of funds received from the investor over the cost of construction of the cost sharing construction object transferred to this investor under the Acceptance Act.

According to Russia's central bank<sup>1</sup>, as of January 1, 2021:

- over 303,000 escrow accounts have been opened for cost sharing housing construction;
- the value of escrow funds deposited has exceeded Rb1.19 trillion, which is 8.5-fold than at end-2019;
- Rb126.7 bn have been released from the escrow accounts on construction completion in 64 subjects of the Russian Federation, i.e. have been transferred to the developers' accounts or directed to repayment of credits obtained for projects construction;
- there are 2,242 active mortgage credit agreements worth Rb 2.72 trillion signed between banks and developers which is 200% more than a year earlier.

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<sup>1</sup> URL: <https://cbr.ru/analytics/finansirovanie-dolevogo-stroitelstva/2021-01-01/>

Subsequently, the new project financing scheme which the industry officially adopted from July 1, 2019, engulfs construction across the country at a rapid pace.

Despite the positive market dynamic and the relatively high quality of the total loan portfolio, a number of undesirable effects let themselves known at the end of 2020, in particular, a high increase in the cost of housing (the growth was around 10.5% for 9 months of 2020), which is significantly above the inflation rate and is compounded by a reduction in household incomes, and this largely negates the benefits for borrowers from lower rates.

In H2 2020, transactions for refinancing loans under the top up scheme became more frequent, when the principal debt increases on the back of the interest rate drop. In Q1 2020, the difference between the amount of new and old loan (top up) was 3.8%, and by Q3 the difference went up to 5.6%.

In addition, banks have become more likely to provide loans with a low (less than 20%) down payment: 35% of issued loans in Q3 2020, compared to 28% in Q2 2020. Moreover, this share increased even more from 24% to 40% in the housing mortgage lending for the purchase of housing on the primary market (the benefits apply to this part).

The intention of households to preserve their savings in the face of the ruble's depreciation, low rates on bank deposits and the uncertainty about the further development of the crisis, led to the erosion of the marketable supply from the market.

The accelerated growth of mortgage lending in the wake of economic and socio-political turbulence raises risks of the housing market crisis as well as raises credit risks and trigger negative macroeconomic fallout. The experience of many countries shows that the initial effect of increasing the availability of mortgage finance by lowering the interest rates eventually leads to the opposite effect: lower affordability of housing. In this regard, ensuring high and sustainable growth in real incomes of households which should at least be brought into line with the growth in housing prices should become the main macroeconomic task that contributes to the growth of a high level of housing affordability.

### 3.3.5. The Banking System Resources

The credit institutions still form their reserves primarily from the funds of customers (individuals and legal entities) whose share as of January 1, 2021 amounted to 71.2% of the total bank liabilities (71.4% a year earlier).

The principal bank resources are funds received from individuals<sup>1</sup> which constitute 32,7% of the total bank liabilities, deposits from legal entities<sup>2</sup> except credit institutions, constitute 23,5%, and funds of organizations on settlement accounts<sup>3</sup> come to 14,9%, raised funds from banks including from the Bank of Russia – 12,0%. The share of equity amounted to 10,3%.

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1 Including deposits, funds on accounts, and escrow accounts of individuals opened for cost sharing construction.

2 Including state organizations.

3 Including accounts receivable, fund on brokerage, factoring, and forfeiting transactions.



By the end of 2020, the total volume of retail deposits was Rb32.8 trillion worth, up by Rb2.4 trillion in absolute terms or up by 10.9% over the past year (up by Rb2.0 trillion or 6.9% in 2019).

Last year, the ruble's depreciation propelled the retail deposits growth. The increase in the total number is largely due to the increase in foreign currency deposits by 13.8% (up by 2.2% at the end of 2019). Funds denominated in rubles went up by 6.5% (up by 9.3% in 2019). However, given the US dollar exchange rate dynamic (ruble's appreciation in 2019 and its devaluation in 2020), foreign currency deposits in dollar terms declined by 7.9% against up by 9.8% in 2019.

The level of retail deposits dollarization<sup>1</sup> as a whole remains moderate, during the year the share of foreign currency deposits in the overall amount of retail deposits increased to 25% (at the end of last year – 19.6%). However, this increase is primarily due to the weakening ruble.

One of the most important events of 2020 in the retail deposit market was the adoption of a law<sup>2</sup> that defined a new procedure for collecting tax on retail deposits. Before the introduction of the new procedure, ruble deposits were subject to taxation, the interest on which exceeded the key rate of the Central Bank of the Russian Federation by 5 pp., as well as foreign currency deposits with a rate above 9%. According to the new rules, personal income tax in the amount of 13% is paid when the total amount of interest on all deposits exceeds the non-taxable minimum, which depends on the current value of the key rate of the Bank of Russia, and is determined by the formula:

$$\text{Rb } 1\,000\,000 \times \text{Key rate of the bank of Russia as of January 1}$$

Banks after the end of the year and until February 1, must transmit to the Federal Tax Service data on the amount of interest that was credited to the retail accounts. Based on this data, the tax authorities will sum up all the interest income on deposits and calculate the annual personal income tax. For the first time, citizens will have to pay this tax only in 2022 (no later than December 1, 2022) on the basis of tax notifications received from the tax authority.

In 2020, under the influence of the policy of the Bank of Russia and the reduction of interest rates, the trend to redistribute the savings from term deposits to savings accounts prevailed. In H1 2020, a considerable number of people amassed cash reserves at the beginning of the introduction of restrictive measures, but in the middle of the year, as the situation stabilized and income gradually recovered, the number of deposits stabilized. At the same time, the flow of funds was facilitated by the banks themselves, offering more attractive rates on savings accounts. At the end of the year, the total worth of term retail deposits amounted to Rb21.2 trillion, the annual outflow from the term deposits amounted to Rb1.68 trillion, or 7.3%, while funds on current accounts (excluding funds in escrow accounts) increased by Rb4.1 trillion, or by 54.5% to the tune of Rb11.6 trillion, demand deposits and short-term deposits for up to 30 days gained 25.3%.

<sup>1</sup> All foreign currency deposits.

<sup>2</sup> Federal Law dated April 01, 2020 No. 102-FZ.



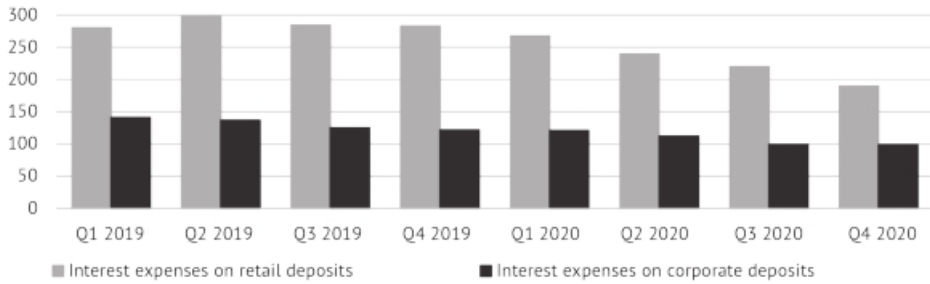
By the end of the year, despite rising inflation, falling real disposable incomes of the households and worsening wage dynamic, the Russian people invested in the currency and increased savings. At the same time, there was a slight revival of public interest in real estate investments and stock market operations. At end-2020, bank profits from the provision of intermediary services under brokerage and similar contracts to individuals and foreign nationals increased by 144.4%, against only 31.1% in 2019. The growth in demand for mutual fund shares from retail investors was due to both lower deposit rates and positive returns on funds. At the end of Q3, the total number of registered mutual funds increased by 4.6% since the beginning of 2020, while the increase in assets over the same period was 7.7%.

The other paramount component of the resource base of Russian banks – corporate customer funds gained Rb6.9 trillion, or 21.0% in 2020, hitting Rb39.6 trillion. The growth rate of funds in accounts has increased significantly in the past year, in 2019 the growth was Rb0.6 trillion, or 2.0% year-on-year. The growth of funds in the ruble segment was 14.6%, in the foreign currency segment-37.8. The share of foreign currency funds in the total volume for the year increased from 27.6% to 31.4%.

The level of interest rates on ruble deposits of legal entities and individuals decreased by an average of 27-30% (the decrease in 2019 was approximately 15-18%), the main reason was the policy of cheap money pursued by the Central Bank of the Russian Federation and measures aimed at increasing the volume of soft lending, which encouraged banks to reduce deposit rates to maintain a stable level of interest margins. The decrease in interest rates affected the dynamic of banks' interest expenses on retail deposits and legal entities, which decreased throughout 2020 (*Fig. 71*).

Rates on foreign currency deposits (US dollar, euro) fluctuated slightly with a predominant downward trend, throughout the year they were in the range below 1%. At the end of 2020, some banks (in particular, Alfa-Bank, Gazprombank, and Saint Petersburg) introduced new rules for servicing accounts in European currency, which came into force on January 1, 2021. Under the new rules, banks charge a monthly fee for maintaining an account in euros. Tariffs can be set as a percentage of the deposit balance or as a fixed commission in absolute terms. Thus, the expenses of the individual client for servicing the bank account may exceed the interest income received, which is actually equivalent to the introduction of a negative interest rate. This policy of banks is due to the fact that the European Central Bank has set a negative rate on deposits in the euro as an anti-crisis measure (as a result of which liabilities in this currency began to bring losses to banks), as well as the strengthening of the euro against the US dollar.

Banks' debt obligations remain not very attractive financial instruments for customers: compared to interest-bearing deposits, the volume of issues is insignificant. The total volume of issued bonds at the end of 2020 hit Rb2.3 trillion (Rb1.9 trillion in 2019), an increase of 19.2% over the year (43.3% over the previous year). The volume of promissory notes issued amounted to Rb397.7 bn, for the year it increased by 4.0% (down by 12.8% in 2019). The total volume of issued



\* Non-governmental commercial organizations.

*Fig. 71. Dynamic of bank interest expenses on retail and corporate deposits\* in 2019–2020, Rb bn.*

Source: Bank of Russia. URL: [http://www.cbr.ru/banking\\_sector/otchetnost-kreditnykh-organizaciy/](http://www.cbr.ru/banking_sector/otchetnost-kreditnykh-organizaciy/).

deposit and savings certificates dropped by 64.6% (down by 75.8% for 2018) and remains at a low level – Rb13 bn.

The financial crisis affected the liquidity of the banking sector, which, in turn, had an impact on the movement of funding volumes on the interbank market. Over the year, the volume of loans and deposits drawn on the Bank of Russia lending facilities grew by 17.4% (down by 76.0% in 2019). Especially noticeable was the increase in loans from the BoR – by 46.8% (down by 6% in 2019), which indicates a deterioration in bank liquidity and increased dependence on loans from the Central Bank of the Russian Federation.

The level of concentration of banking resources remains high. The share of the 5 largest assets of credit institutions accounts for 67.7% of retail deposits (65.5% in 2018) and 58.3% of corporate deposits (59.2% at the end of 2019). The share of funds raised by the 5 largest banks through loans from the Central Bank of the Russian Federation increased significantly again -49.5% (in 2019 – 24.7%).

In 2021, the strengthening of inflationary trends at the beginning of the year does not imply a further reduction in the key rate, so the growth of the bank deposit market will stabilize and will largely be determined by the level of income of the population. At the same time, there is a high probability of an increase in demand for alternative instruments and the emergence of new hybrid deposits with elements of an investment product, as well as the development of insurance products (investment life insurance, cumulative life insurance).

