

Elvira Nabiullina: Review of Russia's economic and financial developments in 2015

Statement by Ms Elvira Nabiullina, Governor of the Bank of Russia, at the plenary meeting of the State Duma of the Russian Federation, Moscow, 14 June 2016.

* * *

Good afternoon, dear colleagues!

Today we present the latest Annual Report of the Bank of Russia to the 6th State Duma. First of all, I would like to thank the deputies for the legislative efforts, which we took together to both develop the financial system and protect the rights of financial services consumers, and for the efficient cooperation with the Bank of Russia. As many as 130 laws affecting the financial sector have been adopted over these three years.

Now, let's look at the Bank of Russia's performance in 2015.

A sharp deterioration in external environment in late 2014 – early 2015 (oil price drop and sanctions) triggered turbulence in the external market and followed by a surge in inflation. These developments required measures to stabilise the situation and help the economy adjust to the worsened conditions.

The first one is a transition to a floating exchange rate of the ruble. This is a pivotal systemic measure. Though this transition was not a smooth one, I would like to stress, should we have failed to take this step, according to our estimates, the economic downturn could have been deeper.

Now the floating exchange rate works as an embedded economic stabiliser that mitigates the external shocks. This is why inflation did not shoot up and financial stability indicators were normal during the new spirals of oil price fall in August-September 2015 and December 2015 – January 2016. The floating exchange rate also allowed us to save gold and currency reserves, a cushion for the national economy.

The second one is a moderately tight monetary policy, which allowed us to drag inflation down and move towards the 4% target by the end of 2017. In spring 2015, inflation came up to 15.0%, stood at 12.9% as of the end of last year, now it is 7.3%, and we expect a 5-6% inflation by the year end.

When deciding on the key rate we always consider the economic environment. Therefore, after a dramatic key rate hike to 17% in December 2014, we were cutting it to 11% in the first half of 2015 and subsequently suspended the reduction as inflation risks had grown. On 10 June, the latest Board meeting decided to cut the key rate to 10.5%.

Our monetary policy is guided by strategic priorities, consistency and adherence to market methods. We relied on conservative forecasts in our decision-making; unfortunately, it was a reasonable thing to do during the whole of 2015.

As a result, we have managed to preserve confidence in the financial system, and the alarming assumptions that capital flow can be restricted or the printing press can be launched are no longer taken seriously.

The third one is special measures of temporary or limited nature. We applied them because the external conditions throughout 2015 were persistently challenging, even extraordinary, and really required the Bank of Russia to take special substandard measures.

The Bank of Russia used special-purpose refinancing instruments which somewhat backed up the real sector in the fields where the market failed: project financing, non-commodity exports, and small business.

Now, the upcoming transition to structural liquidity surplus is putting the expansion of special-purpose instruments on hold. The efficiency of these instruments varies, that is why we will focus on fine-tuning them. Thereby, we have revised the criteria for driving non-commodity exports in order to focus on technological and manufacturing projects. As for project financing, we will refinance liabilities only for the projects already selected by the Interdepartmental Commission. The use of allocated limits only slightly exceeds 70% or 97 billion rubles.

To solve the issue of external debt repayments, FX refinancing instruments were used.

As a result, the external debt shrank by \$84 billion, i.e. by 16%, in 2015. The total debt reduction for the two years was 30%. It means that the debt burden for our economy has decreased considerably.

Banks' demand for foreign currency, provided by the Bank of Russia, was sinking noticeably over the past year and we are gradually abandoning these instruments. We expect banks to redeem the FX debt by the end of next year.

We offered banks temporary regulatory easing to support the financial system. It reached the target and was curtailed by the end of last year. Thereby, we backed up the capability of the banking system to lend to the economy, but avoided risk accumulation triggered by excessive regulatory easing.

We have managed to preserve households' confidence in financial institutions: instead of a bank run we saw ruble deposits growing by 25%.

What are our current objectives? It is the interest rate policy that will allow us to achieve the 4% inflation target by the end of 2017. Our inflation targeting principle is that the Bank of Russia does not curb inflation at all costs, but considers the economic environment and financial stability issues when taking decisions. I insist that the policy of dragging inflation down to 4% is in line with the general economic policy designed to create conditions for the economic growth.

Lending will see a transition from structural liquidity deficit to structural liquidity surplus, and this is a very important development. So far, the Bank of Russia issued loans to banks which reached up to 4 trillion rubles last year. Now, as the budget spends the reserve funds, the Bank of Russia will absorb this liquidity (through deposit operations, among other things) to keep the interest rates manageable, and we are already preparing a trial issue of Bank of Russia bonds. This tuning of monetary policy instruments will ensure manageability of interest rates in the money market, in lending and in the economy as a whole.

On the development of the banking sector.

The Bank of Russia sought to pursue a balanced policy in developing the banking sector. On the one hand, we helped banks adjust to the new conditions and eased banking regulation, on the other hand, we stuck to the policy of resolution of the banking system and countering fictitious transactions. Our key objective is to have a sustainable, capitalised financial system capable of funding the economic growth.

In 2015, the banking system accumulated capital, household deposits recovered, and lending to the real sector grew slightly.

In the first half of the year, the banking system suffered losses, but returned to profits by the year end. Profit stood at 192 billion rubles in 2015, and 234 billion rubles in the first five months of 2016. In 2016, we expect profit to be about 500 billion rubles.

To develop the banking regulation, the Bank of Russia continued to introduce international standards, including Basel regulations, implemented compensatory measures to ease the adjustment of the banking system to the new environment, and introduced its own regulatory measures which take account of the specific risks of the Russian banking system. We continued to pursue a sequential policy of banking sector resolution. Unfortunately, the pace of licence revocation was high. Here we seek to occupy a more proactive position in

supervision, and take early warning and preventive measures. For this purpose we improve our internal procedures. Thus, we decided to establish a risk assessment service.

We believe that, in order to prevent problems at an early stage, the Bank of Russia should be granted the right for professional judgment, because the current strictly formalised approach to banking supervision often does not allow us to intervene when banks still have some assets, i.e. the owners have not yet withdrawn all of them. It is important mainly to protect creditors' rights.

The changed attitude to resolution also needs further discussion. Resolution has become a more frequent measure. We tightened requirements for turnaround managers over the year and will continue to do so.

Now about the Bank of Russia's activity as a megaregulator.

We seek to enhance cross-sectoral approach in supervision and regulation, and in 2015, we worked out the first key document covering all sectors of the financial industry, 'Guidelines for the Development of the Russian Financial Market in 2016–2018'. This document is envisaged by the law. We held detailed discussions of this project with business associations, including in parliamentary hearings, presented it in Russian regions for businesses to understand and contribute to our measures to develop the financial market.

Some words about our achievements in the sector of non-bank financial institutions.

Today, OSAGO is likely to be the most socially significant type of insurance. Let me remind you that in 2015 the tariffs were adjusted for the first time since the introduction of the compulsory motor insurance. By that time the situation in the OSAGO market was a challenging one. In some regions it was almost impossible to buy the policy without additional foisted services, there were difficulties with reimbursement of damages. The overall situation has improved, but some regions still experience difficulties with OSAGO. We have introduced an electronic OSAGO policy. For now, only 200,000 electronic policies have been issued, that is not many. Therefore, we welcome the law that would bind insurers to issue an electronic policy upon the customer's request from January 2017.

Last year, we improved the European accident statement rules – documenting road traffic accidents without involvement of the road police has become easier and more convenient.

Microfinance organisations. Microfinancing is discussed with fervour. I would like to stress, that we believe it to be short-sighted to ban microfinancing. Short-term loans are in demand and if there is no regulated business, consumers will turn to illegal lenders. We took measures to ensure better protection of citizens' rights, primarily, by limiting the maximum effective interest rate and fines and interests on overdue loans. And I believe we should move from the fourfold maximum to the twofold on the legislative level.

As for illegal lenders, this problem needs a legislative solution, among other things. The accountability of illegal lenders is currently not very serious, so to say. Moreover, ironically enough, the illegal lender can recover the debt in court. We believe it to be important to deprive agreements with illegal lenders of relief at law.

Non-governmental pension funds. We have established a system of pension savings guarantees. Now it includes 38 of 91 eligible funds inspected by the Bank of Russia. Many funds had to improve the quality of their assets to enter the system.

Furthermore, actuarial industry has been launched in compliance with the law; today we have a bit more than 100 actuaries. They are active and it is an important segment of the financial market established last year.

We have almost stamped out unscrupulous depositories which provided bogus excerpts on available securities. We implemented our function of a megaregulator which allowed us to make cross-checks and reveal such situations immediately. We took measures under the project "Clean Register".

We have developed and are implementing the road map on electronic communication in the financial market. Electronic communication decreases companies' costs and ultimately the price of services for consumers, provides adequate financial inclusion to avoid having dependence on actual branches.

New digital technologies quickly transform the financial sector. We have established a special technology and innovation task force at the Bank of Russia which is to study technological trends in the field of finance, and to timely reveal the areas requiring regulatory and supervisory changes. We seek to avoid hampering the development of new, more efficient and user-friendly technological solutions, but prevent accumulation of risks capable of mitigating consumer right protection. Last year we established a Centre for Cyber-attack Monitoring and Response in the Financial Sector (FinCERT), which provides, among other things, methodological assistance in ensuring the highest possible cyber-protection to market participants.

We always cooperate with the market in financial technologies and innovations. Thereby, in 2015, we held the first forum on innovative financial technologies; it was in demand with businesses and we are going to hold it again in autumn.

We have established an institution of bond programmes. The development of debt instruments is extremely important for our financial market, because it is the best instrument for large companies, while banks should be more focused on lending to small and medium-sized businesses.

In 2015, we laid foundations for the development of a national rating industry, and the new legislation allows us to expect that a really respectable and professional rating industry will be built in our country.

Now about the national payment system.

In 2015, operations and clearing centre of the NPCCS was launched. It processes all operations made in Russia through cards of international payment systems. The transfer of payments into Russia was implemented in a very short period due to external risks but its implementation was of high technological quality in line with international standards. In the end of the last year a pilot issue of national payment system cards Mir was implemented. The cards are already issued by banks of the Crimea (and accepted throughout the Crimea) and some other banks. The mass issue of the cards is to start in the second half of the year.

Besides, we have improved the system of Bank of Russia financial messaging system, a SWIFT counterpart. It complies with all SWIFT formats and everyone can use this convenient format to transfer messages domestically. We closely cooperate with our colleagues in Belarus and Kazakhstan in coordinating the development of the national payment systems.

Some words about countering fictitious transactions.

According to our estimates, fictitious transactions have shrunk by about one-third. The monitoring has become more efficient. Fictitious transactions in the non-bank sector are better revealed due to, among other things, our thorough inspections we can implement as a megaregulator.

In 2015, quite a few unscrupulous players were swept off the market: 93 banks, 96 insurance companies, 21 non-governmental pension funds, 1,703 microfinance organisations, and 609 professional securities market participants. One of the reasons behind it was servicing the shadow sector of the economy.

Looking back at the year, I would like to say that it was undoubtedly challenging with external environment constantly changing for the worse, but for all that we have achieved some important results. First, the economy showed its adaptability, and not a passive one. We can see that new sectors, the whole sectors have managed to grow amid an extremely worsened environment. There were also enterprises in the generally failing sectors which took the new possibilities and show potential for development. Second, the last year clearly signalled that

structural reforms are needed for the economy to return to sustainable growth; and removing internal restrictions is a short-term objective. I am convinced that we will manage it.

Thank you for your attention. Thank you.