Box

Russia's pre-war position in the international banking system

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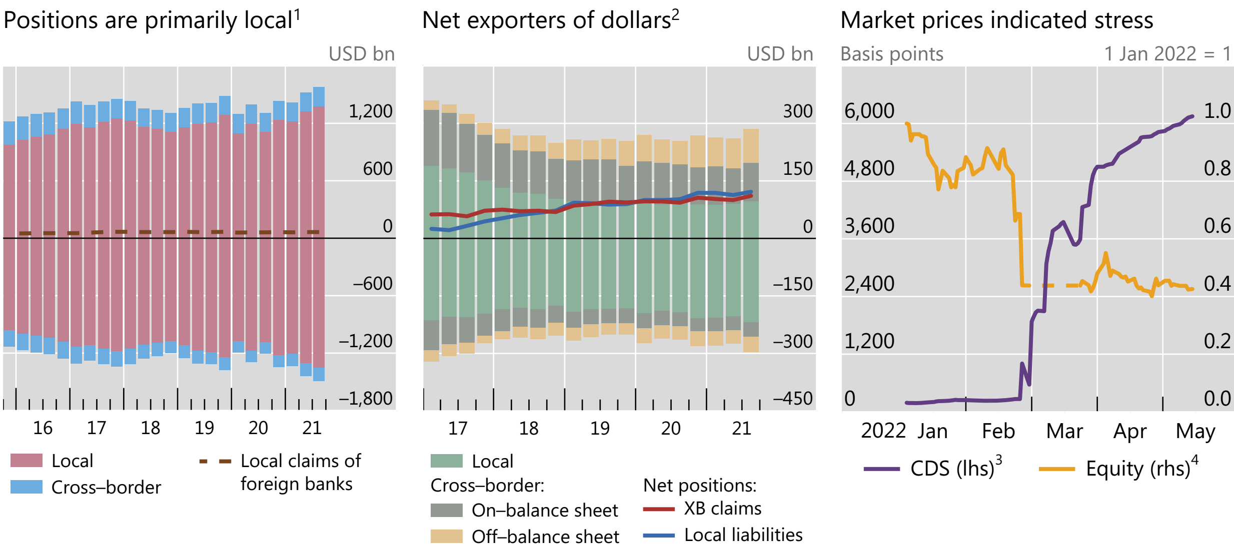
The outbreak of war in Ukraine damaged real economic activity and generated uncertainty in financial markets globally. It triggered sanctions by foreign governments and others on Russian entities and individuals, implemented largely through restrictions on their access to the international financial system. These developments have disrupted the activities of financial institutions domiciled in Russia or with links to the country.②

Using data up to end-2021 – thus prior to the war – this box examines features of the Russian banking system as well as aspects of the international banking system's exposure to the sanctions.③ In particular, it shows that domestic banks dominate the Russian banking sector and that their business is largely local. Nevertheless, market reactions suggest concerns, possibly related to these banks' USD positions and the credit risk of local borrowers. The box also reports that exposures to Russia do not seem to threaten the solvency of foreign banks. Finally, it highlights that, while the Central Bank of the Russian Federation and banks in Russia provide US dollar funding to the rest of the world, Russia is not (with a few exceptions) a significant dollar funding source for banks outside Russia.

Vulnerabilities of Russian banks

Structural features of Russia's domestic banking system limit the scope for sanctions to transmit stress through international banking channels. This system includes predominantly domestic banks, ie banks headquartered in Russia, whose share in all banks' claims on Russia has consistently been estimated at about 95% since 2015. In addition, the positions of banks in Russia are domestically oriented, with claims on and liabilities to entities in Russia accounting for 87% and 91% of the respective totals at end-September 2021 (Graph B1, left-hand panel).

Banks in Russia — Graph B1



[1] Local and cross-border positions of Russian banks and foreign banks' offices in Russia. Positive amounts relate to claims and negatives to liabilities. Local claims of foreign banks in Russia are computed from the consolidated banking statistics on an immediate counterparty basis. [2] Positive (negative) values indicate USD-denominated claims (liabilities). Graph adapted from P McGuire, "FX swaps and forwards in global dollar debt: 'known knowns' and 'known unknowns'", mimeo, 2022. [3] Average of five-year CDS spreads for Sberbank and VTB. [4] Combined market capitalisation of Sberbank and VTB. The dashed line in the right-hand panel indicates stale valuation while trading was suspended between 25 February and 23 March.

Sources: Central Bank of the Russian Federation; IMF balance of payments and international investment position statistics; Datastream; IHS Markit; BIS locational banking statistics (by residence); BIS consolidated banking statistics (immediate counterparty basis).

The sizeable USD positions of banks in Russia create some vulnerabilities to the war's repercussions. While USD assets closely match USD liabilities at the overall level (combining both on- and off-balance sheet items), there is no such match at the level of either local or cross-border positions (Graph B1, centre panel). Most of the USD liabilities come from local depositors (74% in Q3 2021), which are probably commodities exporters with dollar revenues. By contrast, the USD assets are largely cross-border, consisting of both loans and long positions in the FX swap market. Sanctions could affect cross-border and local positions differently and create a divide between them. For one, a decline in the USD revenues of depositors in Russia could lead them to withdraw USD deposits, ultimately generating a USD funding shortage for banks. In turn, impaired access to cross-border USD claims could hamstring the servicing of local USD liabilities.

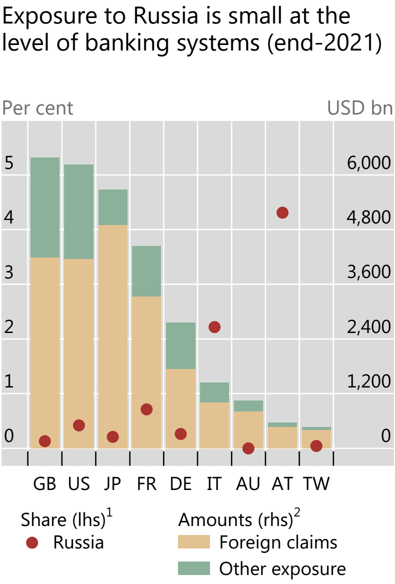
Equity prices and CDS spreads after the war's outbreak suggest great investor concerns about Russian banks (Graph B1, right-hand panel). These banks' domestic focus does not shield them from the risk that the war's repercussions worsen the solvency positions of domestic borrowers. Furthermore, the prospect of stress from cross-border or local USD mismatches likely concerns investors, to the extent that Russian banks, corporates and wealthy individuals have been effectively isolated from international payments and settlements systems for both cash and derivatives markets.④

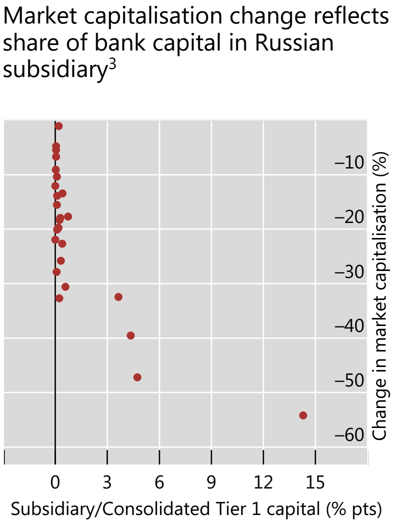
Implications for the international banking system

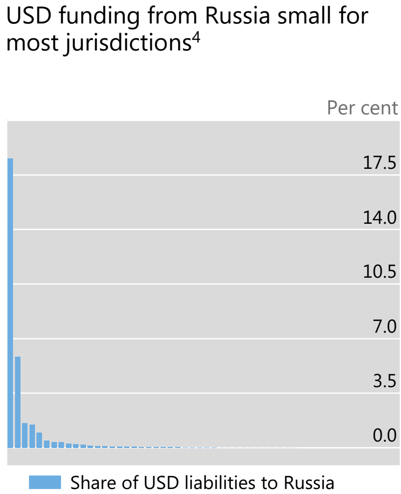
Foreign banks' consolidated claims on borrowers in Russia are small in aggregate. From the perspective of most foreign banking systems, Russia accounts for less than 1% of total foreign exposures – comprising cross-border claims, claims made by local affiliates, and off-balance sheet exposures, such as credit guarantees (Graph B2, left-hand panel, red dots). The country features in the top 10 counterparty locations for only one major banking system, Austria, where it still accounts for less than 5% of domestic banks' total foreign exposures. Across banking systems, typically only a few individual banks have material exposure to Russia.

Russia from the perspective of foreign banks

Graph B2







[1] Total foreign claims and other potential exposure (derivatives, credit commitments and guarantees) on all foreign counterparty countries by bank nationality. [2] Share in total exposure, ie foreign claims plus other potential exposures. [3] Horizontal axis: Tier 1 capital of Russian subsidiaries relative to parents' consolidated Tier 1 capital at end-2021 or most recent available. Vertical axis: change in market capitalisation from 17 February 2022 (one week before onset of the war in Ukraine) to 17 May 2022. [4] Cross-border USD liabilities to Russia divided by total USD liabilities. Each bar represents banks located in a given jurisdiction. The graph shows 47 jurisdictions, seven of which do not report any USD liabilities to Russia. Data as of end-2021.

Sources: S&P Capital IQ Pro; BIS locational banking statistics; BIS consolidated banking statistics (on a guarantor basis).

Zooming in on foreign banks with a physical presence in Russia, the evolution of stock prices after the outbreak of the war suggests some market concern. The negative price reactions tend to be stronger for those few banks with large equity in Russian subsidiaries as a share of consolidated capital (Graph B2, centre panel). However, solvency issues are unlikely to drive these reactions because potential full write-offs of this equity would still leave these banks with Common Equity Tier 1 ratios of at least 11%, well above the regulatory minimum. Instead, markets may be concerned that losses could impair dividend payouts and that closing previously profitable subsidiaries in Russia may affect earnings. Further, while some banks have exited Russia by selling their subsidiaries, those unable to do so may be saddled with obligations to domestic depositors.

While globally Russia is a source of dollar funding, the amounts lent are relatively small from the perspective of the international banking system, with some exceptions. At end-2021, foreign banks' US dollar funding from Russia stood at $52 billion. With 60% of it stemming from either banks in Russia or the central bank,⑤ this funding amounted to less than 0.5% of foreign banks' (on-balance sheet) USD liabilities. At the aggregate level, this share had remained consistently below 1% over the past decade. That said, the share was material for banks in a small number of jurisdictions (Graph B2, right-hand panel). Turning to off-balance sheet positions, foreign banks have taken steps to settle many outstanding obligations linked to Russia, such as dollar-rouble FX swap positions. However, vulnerabilities may surface if some derivatives positions mature without these banks being able to access the roubles needed to settle the contracts.⑥

① The views expressed are those of the authors and do not necessarily reflect the views of the BIS. ② This box does not analyse the positions of Russian banks' affiliates outside Russia or their importance to the host countries they are located in. From the perspective of Russian banks' consolidated positions, their foreign affiliates are small (<5% of assets). For host countries that report data to the BIS, the role of Russian banks in those locations is also small (<0.5% of claims). Nevertheless, these affiliates may struggle in the face of international sanctions, and they may be important to some smaller economies where data are sparser. ③ Russia began reporting data to the locational banking statistics in Q4 2015. Russia has not reported data for Q4 2021. ④ This box does not provide an analysis of the impact of SWIFT-related bans on Russian banks. ⑤ At end-January 2022, Russia's central bank reported foreign currency reserves (in the form of currency and deposits) at $152 billion, including USD, EUR and other currencies, of which $57 billion was placed with foreign banks. ⑥ See eg *Euromoney*, "Groupthink saves billions of dollars for banks on rouble FX swaps", 18 March 2022 and Risk.net, "'Dead' derivatives market leaves big Russia dealers unhedged", 9 March 2022.