

# Elvira Nabiullina: Review of Russia's economic and financial developments in 2018

Speech by Ms Elvira Nabiullina, Governor of the Bank of Russia, at the plenary session of the State Duma of the Russian Federation, Moscow, 30 May 2019.

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Good afternoon, esteemed colleagues.

Today, I draw to your attention the report on the Bank of Russia's activity in 2018.

The Report was sent to the State Duma three weeks ago, and we had a chance to discuss it in working groups, at parliamentary group meetings and at the joint meeting of relevant committees. Allow me to express my gratitude for your attentive consideration and deep interest in what we do.

I would like to dwell on our key activities determined by the Constitution and the Central Bank Law. They are associated with the national development goals set forth in the Presidential May decree and strategic goals of the Bank of Russia.

I will start with **monetary policy issues**. Our main goal is near 4% inflation. This is stipulated in the Presidential decree. Low inflation is paramount to long-term investments and a rise in public prosperity.

We first reached the inflation target in 2017, as we had promised. Since that period, our policy has aimed to keep inflation close to this level.

In 2017 and early 2018, both internal and external factors were favourable and we could cut the key rate, whereas in the second half of 2018 serious inflation risks emerged. They include rising petrol prices, ruble depreciation on the back of both capital outflow from emerging markets and a tougher geopolitical environment, and the decision to raise VAT.

Our monetary policy was aimed at anticipating and preventing these risks. Our key rate influences future rather than current inflation. As a result, we raised the key rate by 0.5 percentage points. This was sufficient for inflation to deviate slightly from the target at the lower bound of our forecast and to promptly resume its movement towards the target. Moreover, it was the prompt response that allowed us to avoid a significant rise in the key rate.

This showed, in particular, that our monetary policy tools have the effect we planned to achieve, address challenges, and allow us preserve a stable environment that favours economic development.

The May and April data suggest that monthly price growth (seasonally adjusted) across all core groups of goods and services has already declined to our target level. Annual inflation is set to return to target in the first half of 2020.

Now that the proinflationary factors we needed to address have largely faded, we believe it is possible to resume rate cuts in the second or third quarter.

## Financial stability

As you know, both internal and external risks may emerge.

One of the tools the Central Bank has at its disposal to control external risks to financial stability is foreign currency reserves. Given the geopolitical environment and unstable oil prices, we are

accumulating foreign currency reserves. Currently, our reserves stand at 491 billion US dollars, which is close to the 500 billion US dollar benchmark we set several years ago. We are pursuing a policy of reserve diversification in order to ensure both safekeeping of reserves and their availability at any time. We increased the share of gold and renminbi, while reducing the share of the US dollar.

We are continuing our pursuit of de-dollarisation policy, or more accurately, a reduction in the share of foreign currency in the financial system; the proportion of FX loans and deposits is decreasing. Foreign debt is also reducing, and was down by 12.4% over the year. We are moving forward with settlements in national currencies with our main trading partners. These measures mitigate Russia's external risks of both economic and political nature.

In the domestic market, measures to enhance financial stability are aimed at cooling the riskiest market segments and preventing bubbles.

We are keeping a close watch on mortgage loans with a low down payment of under 20%. As you may remember, it was high-risk mortgage loans that caused the financial crisis in the US which then spread worldwide. We introduced increased ratios on such mortgages for banks.

Starting this autumn, we will introduce a debt burden indicator for individuals in the consumer lending market – the debt-to-income ratio that banks and microfinance organisations will have to take into account when extending loans. This move should curb growth in household debt: if customers take more loans than they can service, it is a threat to their personal well-being and the stability of banks.

We believe that this move is well timed because the consumer lending market is expanding rapidly, outpacing growth in corporate lending, and we should keep retail lending under control. The average level of household debt burden for the country may seem low: it is currently roughly 10%, which means that on average, households use this share of their income to repay loans. However, when measured for borrowers only, the indicator suggests that they have to spend as much as 44% of their income on repaying loans. Therefore, we need to calculate the debt burden for each individual borrower.

## Development of the banking sector

Last year, banks increased lending and cut interest rates on loans. Lending to the economy rose by 5.8% compared to 3.7% in 2017. In the first four months of this year, **corporate lending** expanded by 2.5%, whereas in the same period of the previous year this figure was 2.3%.

Interest rates on loans went down most of the year until inflation risks turned to growth and the Bank of Russia raised its key rate. We are currently expecting interest rates to resume their downward trend on the back of falling inflation.

Banks can further increase lending, as they have both capital and liquidity. We are introducing incentive-based regulation measures, which should encourage lending to the real sector.

We are placing an increased focus on lending to small businesses, and simplifying regulatory requirements for banks as regards SME lending. They include the scope for securitisation, reduced risk ratios for 'good' loans to small businesses, and banks' possibilities to assess small business customers based on a wide range of data, relieving them of the necessity of preparing complex document packages.

We also introduced insurance of small businesses' accounts with banks, and I thank the deputies for adopting this law. This is another factor of small business development.

Last year, we launched proportionate regulation in the banking sector. Currently, 142 banks hold

basic licences. The priority of these banks is lending to small and medium-sized enterprises. We discuss challenges faced by these banks on both bank associations' platforms and the Bank of Russia's platform, and we are ready to fine-tune our regulation to create the best environment for SME operations.

Moving on to mortgage lending. This is the most socially important type of lending. Last year, mortgage lending expanded at a high pace with interest rates falling throughout most of the year. Currently, banks are resuming rate cuts after a short period of their upward revision – we registered growth to 10.4% after an all-time low of 9.4%. Mortgages are long-term loans, and interest rates depend on inflation and inflation expectations. Our monetary policy is therefore aimed at keeping inflation sustainably low in the long run. This is the key factor for a reduction in interest rates on housing mortgage loans. We believe it is entirely plausible to reduce mortgage interest rates to 8% within the period stipulated in the Presidential decree.

Bank lending is certainly an important, but not the only source of financial resources for businesses. Both debt (loans) and equity (capital participation) instruments are important so that companies can raise funds to deliver on the national objective of raising fixed capital investment to 25%. We have already expanded the range of such instruments. We revise regulations to simplify and accelerate the process of security issue for issuers. They already can register bond programmes, which considerably reduce procedural costs. In the near future, they will be able to register issues electronically. Currently, bonds account for 18% of total corporate borrowing, which is more than 7 trillion rubles. Therefore, the accessibility of borrowings for our companies should mean not only bank lending, but also expansion of corporate bonds.

However, companies need to expand their capital stock along with the use of debt financing. An improved approach to corporate governance is of paramount importance in raising equity financing. Investors will only invest in enterprises whose operations they can understand, where their rights are protected, and there is a clear picture of how they can earn money. Public companies have, therefore, enhanced the controlling and strategic functions of their board of directors, and will continue further enhancement. A board member is not a figurehead, as they may seem, but someone responsible for the company's development. Companies establish functions of risk management and internal controls, and protect dividend rights of their shareholders in the best possible way.

And the last point I would like to make on the banking sector is the outcomes of major banks' resolution under a new mechanism. Last year, we almost completed the resolution of three major banking groups and Asian-Pacific Bank. We created a bank of non-core and toxic assets, and all banks that underwent resolution already operate in the market in compliance with all ratios. It would be fair to say that the most difficult stage of banking sector resolution is behind us. Certainly, it was not painless and came at a cost. Last year, the Bank of Russia registered losses associated with the resolution and establishment of a non-core asset bank. However, the losses on the Bank of Russia's balance sheet mean that depositors keep their money and entrepreneurs whose funds were placed in accounts with these banks remain solvent. We avoided larger losses in the economy and knock-on effects in the financial market. Our current objective is to return as much funds as possible through the sale of these banks and operations with non-core assets.

## **Insurance market**

Last year, we launched an OSAGO reform. Its first stage, which included the expansion of the rate corridor, improved applications of the bonus-malus coefficient, and an update of driving licence categories, has already reduced the cost of OSAGO in nearly all regions, with a country-average decrease in the policy cost totalling 4%. The next stage involves rate personalisation for drivers; it should ultimately solve problems faced by OSAGO policy holders. Firstly, it should put an end to the injustice when careful and responsible drivers have to pay for those who drive in a

risky manner and often have accidents.

## **Microfinance organisations**

The microfinance market faces the same fair criticism now as in recent years because of usurious interest rates, and incredible fines and penalties. We came up with a serious tightening of the regulation of microfinance organisations. Currently, there are half as many such organisations in the market as there used to be five years ago. From now on, the law caps interest rates at 1% per day, while the full cost of borrowing with all fines and penalties included is limited to 1.5 times the loan amount. These conditions will allow borrowers to use microfinancing to settle their temporary financial problems without running the risk of ending up in an even worse situation.

Moving forward, we believe that one of our priorities is to prevent losses from illegal operations in the economy and damages from fraud suffered by households.

The value of dubious transactions in the financial system continued to decline last year, and this is a stable trend of recent years. The slides show data over several years. Cashing-out transactions halved, while illegal overseas withdrawals shrank by 20%. These are last year figures.

The development of digital technologies increases potential cyber-risks. We are controlling cyber-resilience of financial organisations. The Bank of Russia continuously monitors cyber-attacks and operates a system of information exchange and support for market participants.

As regards the protection of households against fraud, our objective is to minimise the period of time between the moments when a Ponzi scheme or an organisation that illegally provides financial services is revealed and liquidated. This requires large-scale monitoring. Last year, we established two special-purpose centres in our Krasnodar and Khabarovsk branches, which helped us detect fraudulent entities more promptly. Last year, we revealed 168 Ponzi schemes, which is 25% more than the year before.

We are working together with law enforcement agencies, including regional authorities. It is law enforcement agencies that bear responsibility for putting an end to the activity of such illegal entities.

Illegal lenders pose the greatest threat to the public. Under the guise of microfinance organisations (that is why microfinance organisations often face criticism), they offer loans which are sometimes secured against housing, and afterwards demand that borrowers repay enormous amounts of money. Illegal lenders usually operate via the Internet and we must stop their activity. Therefore, we ask you to authorise the Central Bank to promptly block websites advertising illegal financial operations, among other things.

We have already forwarded the respective bill to the State Duma and look forward to your support.

In order to reduce the chances of the public getting trapped by illegal lenders, since last year, we have been working together with Yandex on a joint project aimed at labelling websites of legal trustworthy microfinance organisations registered with the Central Bank with special symbols. We are discussing similar projects with other search engines.

## **Development of the Mir card**

Currently, as many as 59 million cards have been issued; the share of the Mir card has been growing both in issue volumes and cashless operations. Countrywide, people use cards on a daily basis; in more than half of Russian regions, transport cards, and in some regions, also

social cards are attached to the Mir card. We hope this trend will continue.

Mir cards are accepted in member states of the Eurasian Economic Union and Turkey (last year we told you we were conducting negotiations). In the near future, we are planning to ensure that these cards are accepted in non-CIS countries popular with Russian tourists, and to expand their acceptance in CIS countries.

The development of cashless payments is not restricted to the use of Mir cards.

Last year, we completed the development of the Bank of Russia's special project, Faster Payments System (FPS), which we launched early this year.

As many as 14 banks have already joined the system, and 114 more have applied. Our estimates suggest that early next year, 250 banks will have joined the system. At the later stages, only small banks with a basic licence, which need more time to introduce changes, will join.

According to our estimates, the introduction of the Faster Payments System will reduce fees for retail remittances more than 2-3-fold.

We are currently working to further develop the system and ensure payments for goods and services via the Faster Payments System. Firstly, this will support the trend toward the rise in cashless payments, given that FPS fares for trade and service companies will be lower than those for merchant acquiring services. You may remember that this topic is currently very acute.

Last year, we also introduced remote biometric identification for financial services provision. Biometrics is currently collected in branches of 146 banks; by the end of the year, these will be collected in all banks with a universal licence in accordance with regulatory documents. In the near future, biometrics will also be collected in multifunctional centres and used to provide not only financial services, but also other public services in digital format. Given these factors, we expect that the use of biometrics will expand considerably next year.

Last year, we launched Masterchain, a blockchain-based project elaborated in association with FinTech Association and market participants; this is an advanced transaction record system. Together with Rosreestr, we have already implemented a masterchain-enabled electronic mortgage project.

## **Consumer protection**

I will now talk about consumer protection. A rare, but one of the most painful situations for consumers in the financial market is when depositors lose an uninsured portion of their deposits with banks from which we revoke licences. I would like to draw your attention to this issue, because it was repeatedly raised at our discussions of changes to the deposit insurance system. If we consider the number of depositors' accounts, 99.5% of them are completely covered with the 1.4 million ruble insurance under the deposit insurance system. However, these are only 57.4% of deposits in terms of value. This suggests that, on the one hand, the current insurance payments provide complete coverage of most depositors' funds (99.5%); on the other hand, however, the public is well informed and keeps their deposited amounts under 1.4 million rubles. Should we increase the insurance coverage in these circumstances? Certainly, this move should not be made in favour of very rich people who, in my opinion, can manage their risks. However, we believe it is reasonable to take a closer look at the situation when a depositor has a large amount of money deposited with one bank by coincidence, because the customer did not have a chance or enough time to manage their funds and the bank's licence was revoked. In such cases, we believe it would be reasonable to increase the insurance coverage. Deputies have proposed this move and we support it.

Which circumstances should this apply to? Inheritance, insurance or social payments, payments awarded by a court decision, proceeds from the sale of real estate, etc. are cases where we deem it possible to raise the insurance coverage to 10 million rubles.

Another aspect of consumer protection is conduct supervision. This is a system that controls whether financial organisations conduct sales, conclude agreements and deliver on their obligations in a reliable manner. Do sellers disclose information about potential risks when they sell their products? Do they provide fair information about returns? Do they impose unnecessary services to customers? Last year, we had to pay attention to the practice of life insurance policy sales. We received a lot of complaints that customers had been lured by high returns, but as a result earned less than they could have earned if they had deposited their money with a bank. Investment life insurance grew at an outpacing rate and the collected insurance premiums reached large amounts. Currently, the market is on a downward trend, shrinking by 27% in the period from 2018 Q1 until 2019 Q1. It is an expected development. This is the result of both the public's disappointment in the product and the regulator's tighter requirements. We want the financial market to demonstrate healthy growth rather than to be driven by deception. Moderate growth rates are acceptable if the market develops in a healthy manner.

Last year, we established the institute of financial ombudsman. A special law we had discussed for many years was adopted. Currently, it is coming into effect and should raise consumer protection. For the public, this will mean a simpler short procedure of dispute settlement with financial organisations. We realise that customers are often weak in disputes with financial organisations, but we are offering them protection.

We continue to develop financial literacy programmes, which has also raised many questions. The regulator will not be able to effectively protect customers without providing information and education to the public. We are working together with the Ministry of Education. The financial literacy module has been included in the school curriculum (29,000 schools or roughly 70% of all secondary schools already have this module in their curriculum). We conduct online and offline workshops and lectures for the public, and we also offer special programmes for orphans and elderly people. We post advertising materials, including on public transport. Our regional branches are making a large contribution, which we find extremely important.

I would like to conclude by saying a few words about financial inclusion. Many deputies are concerned about this issue and raise it at almost every parliamentary group meeting, because voters are concerned about it.

The overall level of financial inclusion in the country is adequate and new technologies are developing faster in Russia than in many other countries. Certainly, they offer new opportunities to households and businesses. This is, certainly, an average indicator typical of big cities. In some regions, where there are many remote and thinly populated towns and rural areas, financial inclusion is low. This remains a pressing issue. Therefore, we adopted a special three-year programme last year to raise financial inclusion and have launched its implementation in every region, taking its specifics into account.

Our key measures include working with major banks with a country-wide branch network to persuade them to stay in such areas before alternative channels emerge, including mobile offices and multifunction automated stations, and new formats, like simple transactions delivered by a post office, and cash withdrawal at points of sales. These options are now available. We are developing remote services in cooperation with Rostelecom. We signed an agreement to have the Internet installed in these areas on a priority basis. Last year, we launched a pilot project to raise financial inclusion in the Far Eastern Federal District and are currently launching it in the Southern Federal District. Financial inclusion challenges in these regions are of higher importance in these regions than in other areas.

We believe that new technologies will open new possibilities for consumers. Currently, 45% of

financial consumers use remote financial services, with the indicator doubling over the past three years. This is a good indicator, because there were doubts whether consumers were willing to use remote services. However, we can see that their willingness is increasing. Therefore, we are placing great efforts to develop financial technologies. I have already mentioned biometric identification, the Faster Payments System, and financial services marketplaces. We are grateful to the State Duma for its contribution to these projects. These are complex projects, but we believe that they are essential to technology development, and among other things, to raising financial inclusion, so that we could bridge that gap between advanced cities and regions and ones where services are unavailable. To conclude, I would like to say that we are continuing consistent efforts in all areas of the Central Bank's responsibility – monetary policy, financial market resolution and strengthening, encouraging competition, the development of the national financial infrastructure, and raising quality and reducing costs of financial services for households and businesses.

I would like to repeatedly thank the State Duma for its cooperation with the Bank of Russia and massive efforts to improve financial market-related laws. This is a tangible contribution to strengthening our financial system, and its capability to foster economic growth and raise public well-being.

Thank you for your time.