

## Elvira Nabiullina: Bank of Russia's 2020 Annual Report

Speech by Ms Elvira Nabiullina, Governor of the Bank of Russia, at the State Duma's plenary session on Bank of Russia's 2020 Annual Report, Moscow, 15 June 2021.

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Good afternoon, Mr Volodin. Good afternoon, esteemed deputies.

Today, I present the Bank of Russia's Annual Report for 2020.

First of all, I would like to thank the deputies for the detailed review of our report at the meetings of the working groups, parliamentary parties, and State Duma committees. You really performed a significant amount of work despite your schedule of the spring session being very tight. Taking this into account, I will therefore do my best to shorten this speech. Nonetheless, I would like to focus on key topics.

Last year was abnormal, and we will remember it for a long time. The pandemic entailed huge losses, and many families lost their loved ones. As we needed to protect people's lives, we had to impose serious restrictions, and they inevitably affected the economy.

Our main task last year was to mitigate the aftermath of the pandemic for households and businesses.

I would like to emphasise that the financial system, the financial sector, helped us overcome the consequences of the pandemic. There are two main reasons why the financial system was able to help all other sectors of the economy, rather than itself needing financial aid, as before.

First, we started 2020 with relatively low inflation, specifically 3% as of the beginning of the year. Furthermore, the average rate over the four years after we had switched to inflation targeting equalled 3.6%.

Second, Russia's banking sector was resilient and had a capital cushion since we had mostly completed its resolution by that moment. Both corporate and retail lending were expanding, with mortgage loans demonstrating record-high growth.

The stable banking system and low inflation were the basic factors enabling us to implement large-scale anti-crisis measures. This was not just a combination of circumstances, but rather the result of many years of work. If we had not stuck firmly to the course for lowering inflation to our target and had not removed weak and unsteady players from the market, we would not have accumulated the safety cushion to provide support to households and businesses.

This is the first crisis in Russia's contemporary history when the banking system did not need additional capitalisation and had no risks to financial stability which might have arisen without the earlier resolution of banks.

During this period, households' and businesses' incomes plummeted, and this slump was totally unexpected. Russia needed urgent measures to provide direct aid, on the one hand, which was ensured by the Government, and to cut costs, on the other hand. This was needed so that people could use their remaining incomes, savings and the financial aid from the Government for daily expenses and maintaining their life quality, and so that companies could cover their cash gaps, pay wages, and ultimately rescue their business.

On its part, the Government introduced tax and rental concessions and subsidised loan programmes. The Bank of Russia took measures through the financial system to reduce people's costs for covering their daily financial needs.

The earliest decisions made at the very beginning of the pandemic were related to loan restructuring. Both households and companies affected by the pandemic were granted loan repayment holidays.

We really appreciate how quickly you approved respective laws for this. Having the capital cushion, the banking system was to act in the most responsible manner during this period. Therefore, banks also offered loan restructuring to clients who were not eligible pursuant to law. Eventually, 12% of all restructured loans to both individuals and small and medium-sized businesses were restructured according to law, and the remaining portion — under banks' in-house programmes.

Currently, we have no concerns about the termination of loan repayment holidays. The majority of borrowers have managed to resume their scheduled repayments. Potentially bad loans are covered by banks' capital cushions. What does this mean? This means that they do not pose any threat to banks' stability or capabilities to expand lending, which is vital at the moment.

Moreover, we granted temporary regulatory easing to banks to be able not only to restructure loans, but also to issue new ones, thus helping the economy. We allowed banks to use their accumulated capital cushions, which enabled them to issue more corporate and mortgage loans.

We shifted towards accommodative monetary policy. I would like to emphasise once again that this was possible due to the steadily low inflation rate we achieved. Owing to the accommodative monetary policy, companies were able to raise cheaper loans, which supported the revival of economic growth.

Last year, corporate lending was up by almost 10%, which is twice as much as in 2019. In other words, companies really had the opportunity to use borrowed resources when they needed this.

As we know from experience, small and medium-sized enterprises are especially vulnerable to crises. In 2014–2015, banks actually stopped providing lending to SMEs. This is why, immediately after the outbreak of the pandemic, we launched a special refinancing instrument amounting to 500 billion rubles at a low interest rate, which dropped as low as 2.25% at the end of the period. This instrument was aimed at incentivising banks to expand lending. We granted these loans only to those banks whose lending to SMEs was at least 90% from the beginning of the pandemic. Coupled with accommodative monetary policy and the Government's programmes, this made it possible to increase lending to small businesses by nearly 23%, which is twice as much as in 2019.

As regards mortgage lending, the Government launched its subsidised programme. It boosted the growth of mortgage lending, households were able to improve their housing conditions, and construction, which is a very important industry for the economy, received the required resources for its fast recovery. However, as the economy bounces back, such a large-scale programme is now mostly pushing up housing prices, and this rise is not covered by the subsidised interest rate. Nor does it improve the affordability of housing for people, while the main goal is to increase the affordability of housing for people.

We needed a shift to more targeted programmes addressing social issues, rather than focused on boosting construction in general. This is exactly why the parameters of the subsidised programme were changed, as was announced by President Putin.

The next measure is reducing people's and companies' costs for covering their daily financial needs. In other words, this is not only loan restructuring and new loans which largely offset plummeting incomes, but also lower costs in the financial sector.

We introduced a free limit of 100,000 rubles for P2P money transfers in the Faster Payments

System and obliged all banks to provide convenient access to the FPS in their applications. In addition, we limited acquiring fees to reduce companies' costs related to cashless payments. This was a temporary measure, but it helped companies save 1.5% of their non-cash flows.

Accommodative monetary policy and, accordingly, lower deposit rates made people opt for more profitable instruments in the stock market. Russia recorded a surge in the number of retail investors. As of the current moment, almost 13 million people have entered the stock market. They are mostly newcomers in the stock market, and we need to protect their rights. But unfortunately, market players failed to act in a responsible manner in this situation. They made offers to individuals to invest funds in complex, or opaque products, and people could thus lose not only income, but also a part of their investment. Of course, this was the last thing people needed during the pandemic. We are grateful to you for empowering the Bank of Russia to limit the sales of hazardous products to individuals.

Furthermore, we will establish requirements for product selling procedures so that financial institutions cannot mislead retail investors. To this end, we are introducing key information documents on all products which will provide a clear and brief description of a product's main parameters and inherent risks. We also need an open-ended cooling-off period for people, even if they have faced hard selling when some products were offered or promoted, will have the opportunity to reject any services. At the moment, such a period is applied solely to voluntary insurance. I would like to stress that we will continue our efforts to tighten the screws in this area, so to say, until we see that the market behaves more maturely, understanding that it is more beneficial for it to establish long-term relations with customers, rather than swindle money from them right there and then.

Completing the topic of mitigating the aftermath of the pandemic, I would like to say that during the pandemic period we have been implementing measures to help reduce the impact of inevitable restrictions and support households and companies, without disrupting fundamental interconnections in the market and compromising stability. The latter is critical for the financial sector and essential for people and businesses using services provided by the financial sector.

Currently, the financial system is functioning normally, is resilient and able to cover the needs of the growing economy.

The slump of early 2020 was followed by a rather rapid recovery. This surge was coupled with a global rise in commodity prices and faster inflation both in Russia and worldwide. Demand has already restored, which is evident from all indicators. Contrastingly, production will need more time. This is due to disruptions in production chains that have not been fully restored yet. There are shortages of some components and materials and workers in certain professions.

As the borders are closed, it is impossible to engage non-residents as much as before the pandemic. For instance, this problem is severe in construction, services to a certain extent, and agriculture. All these factors are pushing up prices. Taking into account the nature of inflation, namely the steady growth of prices across a broad range of products observed in recent months, it is clear that we may not just wait until this period ends. The Central Bank needs to use available instruments to bring inflation back to the target. Otherwise, it will threaten people's well-being.

Last year, we cut the key rate — at the outbreak of the pandemic, inflation was low in Russia, and the key rate helped us support lending and demand. As we all know, companies tend to welcome a policy of low interest rates, which makes borrowings cheaper and thus helps them develop their business. Conversely, it reduces households' demand for deposits. If this is also coupled with inflation, households' real incomes decline and savings depreciate. Figuratively speaking, we can say that monetary policy is like seasonal clothing: we wear jackets when it is cold and hang up our dresses in the wardrobe until the next warm season. The same is true for monetary policy: it significantly influences the situation in the economy and current

developments and helps promote stability, just like adequate clothing keeps us warm without being too hot. Accordingly, now is the right moment to raise the key rate in response to the changed environment and higher inflation.

We had been keeping the key rate at a low level for quite a long period in order to make sure we do not clip the wings of the recovering economy. However, now we have no doubt that our decisions have not hindered growth. The economy has bounced back to its pre-crisis level, even surpassing it in many industries, and continues to expand.

If we delayed the start of the key rate increase, inflation could have sped up in an even worse fashion and more persistently. We could have faced a so-called inflationary spiral when inflation continues to rise increasingly faster. In such circumstances, only radical measures might alter the situation. Therefore, we are taking proactive decisive steps, thus preventing a situation in the future which could force us to change the key rate drastically. We believe that our policy will bring inflation back closer to its 4% target in the second half of the next year. The increased key rate does not impact inflation instantaneously, but rather has a time-lagged effect on the economy. This is why economic processes are currently developing in this way.

However, inflation as it stands will already affect savings to a lesser extent as banks will raise their deposit rates following the increase in the key rate. We can already see the start of this trend now. Of course, this will influence not only savings, but also the purchasing power of households' incomes as people will not have to spend increasingly more money to cover their everyday needs. At the same time, the increase in the key rate will not hinder mortgage lending expansion. Mortgage loans are long-term loans issued for 10, 15 or even 30 years, and interest rates in this segment depend on inflation much more than on the key rate. I would like to emphasise this factor. Understanding that inflation will be close to the target, banks will not set excessively high mortgage rates. This situation was observed before the pandemic, when interest rates were low. Mortgage lending started to expand extensively even before the pandemic. This is control over inflation that helps generate long-term money, long-term loans, and mortgage loans.

Other challenges existing today are associated with the changes brought about by the pandemic. We could see that remote services were crucial during the pandemic. They included both financial services, e.g. bank apps, as well as non-financial ones, such as taxi hailing apps and ones dealing with large purchases. Many such services are integrated into ecosystems that are forming, so to say, around large banks and technological companies. This creates a lot of advantages for consumers as everything they need is close at hand. However, this also poses risks. It is thus crucial to ensure personal data protection and limit the risks of investment in non-core assets. Therefore, we are currently drafting principles for regulating and controlling ecosystem risks and will discuss this topic. We will certainly need lawmakers' support in this regard.

Speaking of a digital ruble, this initiative is strategically important for the task I have addressed today: lower costs for households and businesses. Digital currency will make it possible to transfer payments more cheaply and better protect transactions.

A digital ruble is a very promising project, but it is only one of the elements of the national financial infrastructure. Previously, I stated multiple times, including in the State Duma, that it is vital for us to have our own national financial infrastructure.

We now have the Mir card that is continuing to develop and the national Financial Messaging System which is an analogue of SWIFT we created after 2014. This system currently services over 20% of financial messages inside the country and is capable of servicing the entire domestic traffic if needs be.

The Faster Payments System is advancing. As I have said earlier, it played a critical role last

year ensuring P2P money transfers — to family members, friends and acquaintances: when people needed to make a money transfer, they had the opportunity to make it cheaply and instantaneously.

Today, the Faster Payments System is advancing to the next level enabling not only P2P money transfers, but also payments for goods and services. As was announced by President Putin, all related costs for small businesses will be compensated from the budget until the end of the year. This will make it easier for small businesses to connect to this system. It is essential that all systemically important banks must connect to the system by 1 July. As of the current moment, 10 of the 12 systemically important banks have connected to the FPS. We hope that the remaining ones will be compliant with the deadline. We reviewed these issues related to the development of the national payment infrastructure during the panel discussion, and my colleagues answered all the questions and spoke on our plans. This is really a crucial area.

Winding up, I would like to say that we will continue our efforts to ensure price and financial stability, maintain the resilience of the financial sector, and enhance financial inclusion. Despite the pandemic, this topic also remained relevant for us since people even in small localities should have access to basic services.

We have achieved significant progress in each of these areas.

Today, I would like to thank the Seventh State Duma for the really enormous contribution to the advancement of financial laws. You have adopted many essential laws.

I would like to mention a few very complicated major legislative changes enabling us to develop a modern financial sector meeting the needs of Russian people and companies.

In 2017, the State Duma approved the law on banks' financial resolution. Without this law, it would have been impossible to avoid losses for households and businesses that kept their money with several very large but, unfortunately, hopelessly impaired banks. I would like to reiterate that when we allocated funds for their resolution, this was not to provide financial aid to the banks' owners and management, but rather to protect the funds of the banks' depositors. Russia has completed the reform in compulsory motor third-party liability insurance. There were many discussions and doubts about it. Nonetheless, we believe that it has made the system fairer, and careful drivers now spend less money on insurance than those whose driving involves accident risks. Moreover, the problem of access to insurance policies has been resolved in almost all regions. Furthermore, the State Duma adopted important laws on the development of financial assets, remote services, and the biometric system which are prerequisites for the future competitiveness of our financial system. We expanded the deposit insurance system to protect individual entrepreneurs' funds. Previously, the system mostly protected only households' funds. The system is now already advancing to a new level and is actually expanding to embrace businesses and institutions. Insurance compensation was increased to 10 million rubles in special cases. I am very glad that we have been discussing the new initiative for insurance expansion in recent days as well.

Thank you very much for your efforts in law making, for the ever-meaningful collaboration with the Central Bank, and for your attention to the issues of development in finance. This is essential since the advancement of the financial area is not an end in itself, but rather a prerequisite that will ensure economic development and improve people's welfare.

Thank you very much for your attention. Of course, I am ready to answer your questions.