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Russia's banking sector and its EU-owned significant banks, against the backdrop of war and sanctions

Stephan Barisitz, Philippe Deswel¹

Russia's invasion of Ukraine in February 2022 and unprecedented waves of Western sanctions have worsened the overall economic environment for the Russian banking system and European banks that are active in the country. The suspension of the publication of key prudential indicators by the Bank of Russia (CBR) since the outbreak of the war has also rendered an analysis of most recent banking developments much more difficult. After initial sanctions-triggered instability in March 2022, the authorities managed to re-establish some fragile macroeconomic and financial stability later in spring. Nevertheless, Russia is moving from a resilient post-COVID recovery to a pronounced recession in 2022 and the economy will likely bottom out in 2023. The banking sector, dominated by a few large state-owned players, has gone from driving growth through lending expansion to being affected by the downturn and supported by credit subsidy programs. The largest Russian banks (including Sberbank) have been sanctioned and barred from SWIFT (market share of these banks: almost two-thirds of total sector assets). Due to sanctions and the downswing, the banking sector made a loss of about USD 25 billion in the first half of 2022 (around 12% of its registered capital or more than a fifth of its additional capital buffers at end-2021), the sector's first loss in seven years. Although Western jurisdictions froze about half of Russia's sizable international reserves in February, the authorities have continued to benefit in recent months from substantial revenue inflows due to very high energy prices. The CBR and the government currently appear prepared to support the economy and banks through 2022 and probably 2023, even in the likely event that banks lose a much larger share of their capital due to the unfolding crisis. In this context, the European banks that qualify as significant institutions (Raiffeisenbank Russia, Rosbank/Société Générale and UniCredit Bank Russia) have been fundamentally revising their strategies and activities. The war in Ukraine and Western sanctions have strongly increased the level of risk of their activities and led them to initiate various disengagement strategies (ranging from full exit to a material reduction of operations). Their provisioning levels have noticeably increased, especially with respect to credit risk in a situation where the risk outlook has materially deteriorated for a wide range of counterparties. Emerging risk factors like cyber risk, exchange rate risk (with the complexity of hedging strategies), market risk (given increased volatility and funding costs) and noncompliance risk with the latest sanctions regime have required enhanced monitoring. Reputational risk appears as a key risk factor. Available projections show a capacity for European banks to resist further shocks. They are also accumulating capital in light of the resilient war-time profitability they have shown so far and their incapacity to distribute dividends abroad. Yet Russia's war in Ukraine represents a paradigm shift given the large share of previously identified threats (in the pre-war period) that materialized in swift succession.

JEL classification: G21, G28, P34

Keywords: banking sector, European banks, Russia, financial stability, sanctions, COVID-19, crisis, crisis-response measures, credit risk, nonperforming loans, profitability, regulatory forbearance, shock-absorbing factors

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Given dramatic developments in recent months triggered by Russia's invasion of Ukraine in late February 2022, this brief study constitutes an update of the authors' article "European banks in Russia: developments and perspectives from 2017 through the COVID-19 pandemic (2020/2021)" published in Focus on European Economic Integration Q3/21 (Barisitz and Deswel, 2021). This update covers the period from 2021 to October 2022. We appear to be witnessing a decisive change, and the war and sanctions have rendered European banks' activity in Russia – which remained resilient and profitable in the past few years – considerably more difficult and brought material financial and reputational risks. After a snapshot of developments in the macroeconomic environment and overall Russian banking sector (section 1), the study focuses on recent experiences of the three large European banks in Russia (Raiffeisenbank, Rosbank/Société Générale and UniCredit Bank; it does not necessarily apply to other European banks that have or had exposure to Russia)² with an update in light of the war and new sanctions (section 2). Conclusions (section 3) on current risks and shock-absorbing factors and an outlook (section 4) wrap up the study.

1 Developments in the macroeconomic environment and overall banking sector

1.1 From strong post-COVID recovery in 2021 to pronounced recession triggered by war and sanctions in 2022

The oil price recovery from its pandemic-related low in spring 2020 has given a fillip to Russia's economy throughout the last two years. 2021 GDP growth of 4.7% by far offset the COVID-triggered shrinkage of 2020 (–2.7%). Brisk 2021 growth was driven by private consumption and fixed investment. The average Urals oil price rose by almost two thirds to USD 69 per barrel in 2021 against the previous year, and further rose by about 22% in the period from January to September 2022 (to USD 81, year on year). Rising oil prices were driven by the global economic recovery, the OPEC+ agreement and, from early 2022, escalating geopolitical tensions in Eastern Europe. The Russian unemployment rate (ILO methodology) declined to 3.9% in August 2022 – the lowest post-Soviet level to date.

Russia's invasion of Ukraine (from February 24, 2022) and the unprecedented waves of Western sanctions³ that ensued profoundly changed the playing field. Punitive measures include the freezing of almost half (about USD 300 billion) of the Bank of Russia's international reserves (of USD 630 billion in late February) – the part placed in Western countries' jurisdictions – a unique step so far.⁴

² More precisely, as in the abovementioned previous study, we focus on the three EU-owned banks qualifying as significant institutions in the Russian market (until May 2022, when one was sold to a domestic investor). For readability purposes, the three credit institutions named above are hereafter referred to as "EU-owned significant banks." There are no other foreign-owned significant banks in the country.

³ In our paper, "Western" generally refers to the EU and the G7 (EU member countries France, Germany and Italy as well as the United States, the United Kingdom, Canada and Japan).

⁴ Given that Russian (Minister of Finance Siluanov) and other sources (e.g. Véron and Kirschenbaum, 2022) argue that frozen CBR reserves total about USD 300 billion, the remainder of these reserves, can therefore be considered unfrozen.

Moreover, the assets of a number of Russian banks, including the largest, Sberbank,⁵ were frozen and/or banks were excluded from the international financial messaging service SWIFT.⁶ Additional export controls were imposed, on top of existing controls on high-tech products and aircraft parts and components. G7 countries unilaterally stripped Russia of its most favored nation status in trade with them. The US furthermore issued an embargo on purchases of oil, gas and gold, and the EU on purchases of coal from Russia; in June, the EU decided to ban all oil imports from Russia delivered by tankers (the majority of EU oil imports), but only from late 2022. A number of renowned Western firms have already withdrawn or curtailed their activities in the country.⁷ Russia has responded with selective punitive countermeasures (e.g. cessation of gas exports to EU members that refuse to comply with Russia's demand to pay for gas in ruble, followed in September by near-total suspension of gas deliveries to the EU).

On February 28, in order to prevent monetary and financial destabilization, the Bank of Russia (CBR) more than doubled its key rate (policy rate) from 9.5% to 20.0%, following four previous raises over six months that had added up to three percentage points. Exporters were instructed to exchange 80% of their forex proceeds into ruble, and some other capital controls were established (e.g. restrictions on retail forex purchases, on withdrawals from forex-denominated accounts and on capital or dividend transfers abroad).⁸ The CBR moreover intervened with the unfrozen part of its reserves and reportedly spent USD 34 billion (Le Monde, 2022a) to support the ruble. Thanks also to asset valuation changes, this unfrozen part shrunk to USD 252 billion (about 14% of GDP) as of mid-November. The Moscow Stock Exchange was closed for a couple of weeks, then reopened in late March, although a "temporary" ban was imposed on foreign firms and nonresidents selling Russian assets and repatriating the proceeds. A broad sell-off resumed when the market reopened with a sustained downward trend. The ruble – no longer fully convertible – initially lost almost half of its value against the US dollar and the euro from mid-February, but fully recouped its losses

⁵ *Altogether, the assets of credit institutions accounting for about three quarters of total banking sector assets were frozen. Ten banks (including seven of the ten largest, see table 3) were excluded from SWIFT, namely Sberbank, Vneshtorgbank (VTB), Rosselkhozbank (Russian Agricultural Bank), Moskovsky kreditny bank (Credit Bank of Moscow), Bank Otkrytie, Sovcombank, Promsvyazbank, Novikombank, Bank Rossiya, Vneshekonombank (VEB). These ten banks' assets exceed 60% of total sector assets (Allinger et al., 2022; p. 57; Deuber and Gadeev, 2022).*

⁶ *While the banning of Sberbank and some other Russian banks from SWIFT had a smaller impact on the domestic Russian market – as explained in subsection 1.2 – these new measures contributed to a run on customer deposits at Sberbank's foreign subsidiaries. In early May, its Austrian-based European business (Sberbank Europe) that operated 187 branches across Central Europe with 770,000 customers (0.8% of the total number of Sberbank's customers) was put into orderly liquidation – the first credit institution to fail following the sanctions on Russia (Financial Times, 2022a) and an efficiently managed cross-border resolution under the Single Resolution Mechanism (SRM). VTB Bank Europe, the second bank to fail under sanctions, was also a subsidiary outside Russia (Wiener Zeitung, 2022) and wound down.*

⁷ *Many of the firms that withdrew from Russia appear however to have secured contractual return options (Die Welt, 2022).*

⁸ *To be more precise with respect to the retail forex sector: retail purchases of forex cash in banks were prohibited in early March and a limit of the equivalent of USD 10,000 was established for withdrawals from forex accounts, while larger amounts can be withdrawn in ruble at the exchange rate of the day of the withdrawal. The ban on cash forex purchases was loosened in late May in the sense that banks can sell dollar or euro that they have received since April 9.*

by mid-April, and as of early November, was even 15% to 20% more expensive than prior to the invasion. This is largely due to a combination of still very high levels of energy prices and revenues (even after generous discounts), the authorities' remaining capital controls (even after some easing), the impact of Western trade sanctions mostly cutting into Russian imports, and the Russian gas-for-ruble scheme imposed on EU importers.⁹

CPI inflation (year on year), pushed by strong domestic demand and structural bottlenecks, grew from 5% to 6% in early 2021 to 9.2% at end-February 2022. Post-invasion, it rapidly accelerated to 17.8% at end-April (the highest level in the last 20 years), before easing to 12.6% (end-October). The sharp rise in March-April was largely due to a convergence of temporary factors (the initial ruble plunge, consumers panic-buying food and durables, and a spike in households' inflation expectations) and longer-lasting factors (sanctions- and uncertainty-driven supply chain disruptions) (Ekonomicheskaya Ekspertnaya Gruppya, 2022a; pp. 5, 6, 28). Once temporary factors, inflation dynamics and inflation expectations had weakened or were weakening, the CBR successively cut back its key rate to 17% in early April, 14% in early May, 11% in late May, 9.5% in mid-June, 8% in late July and 7.5% in mid-September. The decline of inflationary pressure and the restabilization of the ruble persuaded the authorities, in late May 2022, to cut the share of exporters' mandatory exchange of forex proceeds from 80% to 50% and, in mid-June, to abolish the mandatory exchange rule.¹⁰

According to the CBR, the Russian economy has entered a phase of far-reaching "structural adjustment" toward more self-reliance and less dependence on Western imports, which will also modify the domestic price structure and put upward pressure on the prices of certain products (Bank Rossii (ed.), 2022a). Notwithstanding gathering economic difficulties, GDP continued to expand by 3.5% in the first quarter of 2022 (year on year), driven largely by consumption, fixed investment and exports. Yet in the second and third quarters, growth turned strongly negative to -4.1% and -4.0%, respectively (year on year), producing an overall economic contraction of 1.8% in the period from January to September (as against the same period of the previous year).

In 2021, the general government budget again produced a surplus (of 0.7% of GDP), after deficit spending in the 2020 recession. Buoyed by very high oil prices, fiscal surpluses continued in the first half of 2022, but turned into hefty monthly deficits in July and August, followed by a smaller shortfall in September, yielding only a very modest surplus (about 0.1% of pro rata GDP) in the period from January to September. The most recent fiscal deterioration was due to a combination of ruble appreciation (against USD-denominated oil sales), declining import tax revenues and boosted spending. The assets of the National Wealth Fund (NWF) were slightly larger at end-October 2022 (USD 184.8 billion or about 8% of GDP) than at the beginning of the year.¹¹ In reaction to the sanctions, the authorities announced increased social assistance payments, pension adjustments, tax breaks and financial support for enterprises. That said, a substantial anticyclical fiscal stimulus

⁹ For a more precise discussion of the factors influencing the ruble's exchange rate post-invasion see *Itskhoki and Mukhin (2022)*.

¹⁰ Since then, a government commission has decided amounts of mandatory exchange.

¹¹ 69% of these assets, or USD 127.9 billion, are reported to be liquid assets on accounts of the CBR.

Table 1

Russia: selected macroeconomic indicators

	2019	2020	2021	H1 22	2022 ⁶
	%				
Real GDP growth (year on year)	2.2	-2.7	4.7	-0.5	-3.4
Inflation (CPI, end of period, year on year)	3.0	4.9	8.4	15.9	..
Unemployment rate (ILO definition, average)	4.6	5.8	4.8	June: 3.9	4.2 ⁵
Budget balance (general government, % of GDP)	1.9	-4.0	0.8	4.1	-2.0 ⁵
National Wealth Fund ¹ (end of period, % of GDP)	6.9	11.7	10.4	11.8	..
General government gross debt (end of period, % of GDP)	12.4	17.6	16.0	13.3	13.0 ⁵
Current account balance (% of GDP)	3.9	2.4	6.9	16.1	13.0 ⁵
Net private capital flows (% of GDP)	-1.6	-3.1	-4.6	..	..
Gross external debt (end of period, % of GDP)	29.0	29.2	28.4	19.7	19.0 ⁵
Gross international reserves (including gold, end of period, % of GDP)	32.6	38.2	35.5	15.0 ³ / 31.9 ⁴	..
CBR key rate ² (end of period)	6.25	4.25	8.5	9.5	..

Source: Rosstat, Bank of Russia, Ministry of Finance.

¹ The predominant part of this fund is also included in Russia's gross international reserves.

² The Russian central bank's one-week-repo rate.

³ Remaining accessible reserves after Western countries froze large portions of these reserves located in their jurisdictions (ca. USD 300 billion).

⁴ Total gross international reserves, including frozen portions.

⁵ *wiiv* forecast, October 2022.

⁶ IMF October forecast.

is reportedly not planned. The oil price rise contributed to boosting the country's current account surplus to 6.9% of GDP in 2021 and further to a record 16% of (pro rata) GDP in the first half of 2022. Yet these surpluses were all but offset by net private capital outflows. Russia's gross foreign debt shrunk slightly in the first six months of 2022 and came to 26.6% of GDP at end-June. Despite partial freezing of reserves, continuous substantial inflows of oil and gas proceeds in the first half of 2022 contributed to maintaining Russia's ability to pay. Notwithstanding the authorities' ability and willingness to pay, Russia defaulted on its foreign debt in June (for more details, see section 3).

1.2 Banks continued to drive growth until early 2022 but now face major impacts from economic downswing

Apart from the oil price, *banking activity*, particularly retail lending, was one of the driving forces of Russia's post-COVID economic recovery in 2021 and the first months of 2022. While available data show a substantial weakening of the economy and bank lending and less so of deposit-taking from March 2022, a number of key macroprudential data – including growth in nonperforming loans (NPLs), forex ratios, external debt ratios, profitability, capital adequacy and loan loss provisions – have not been released since end-January 2022. This of course makes it more difficult to assess the impact of the war and sanctions on banking risks. Moreover, regulatory lenience regarding the measurement of banks' assets and provisioning, which had been lifted in mid-2021 following the weakening of the pandemic, was reinstated in late February 2022 as a crisis-response measure.

In any case, as table 2 shows, banking activity continued its expansion from late 2020 through late February 2022. Loans to enterprises expanded at rates of 3% to 5%, and growth rates of loans to households increased from 8% (end-2020) to 13% to 14% (early 2022) (in real terms and exchange rate-adjusted). Accelerating retail

lending rates were driven by subsidized¹² mortgage loans (+16% to 17% in early 2022), that made up almost half of total retail credit, and by (partly unsecured) consumer loans (+10% to 11% in early 2022). Robust credit expansion contributed to a decline of the NPL ratio from 9% (narrow definition) or 17% (broader definition)¹³ at end-2020 to 7% and 15%, respectively, in early 2022. Loan loss provisions remained slightly above the narrow NPL level. Notwithstanding the slide of the ruble, which accelerated from January 2022 before reversing in late March to April, forex loans' share in total loans remained relatively low (at 16% in early 2022, also on account of the long-standing ban of forex lending to households). Low real interest rates and growing attractiveness of alternative investments in the Russian stock market during most of the observation period (end-2020 to end-September 2022) contributed to the erosion of household deposits (in real terms and exchange rate-adjusted), while enterprise deposits continued to expand and have outsized retail deposits since mid-2021. Banks have remained net external creditors.

After relatively modest profitability during the pandemic with a return on equity (ROE) of 15.7% at end-2020, the sector's ROE exceeded pre-pandemic levels in 2021 (end of year: 21.1%) before easing in early 2022 (end-January: 20.5%). The capital adequacy of the sector, which is dominated by large state-owned banks,¹⁴ remained at about 12% to 12.5% through most of the observation period, before weakening slightly in early 2022 (end-January: 11.8%). As mentioned earlier, the CBR unfortunately discontinued publication of certain important prudential indicators in end-February 2022, including those just mentioned (see also table 2).

The latest available data for banks' credit and deposit dynamics (in real terms and exchange rate-adjusted), for March to September 2022, indicate an abrupt stoppage or reversal of growth, as shown in table 2 and in chart 1. According to the CBR, the sanctions-triggered outflow of households' funds in late February to early March came to RUB 2.4 trillion or 7% to 8% of total retail deposits (Bank Rossii (ed.), 2022b). Looking at month-to-month data, the more than doubling of the key rate at end-February (to 20%) triggered increased credit and deposit rates in March, sharply reducing credit demand, particularly from households, while bringing about a return flow of ruble retail deposits which fully compensated for the outflow by end-April. The return flow was also helped by the ruble's recovery from late March. Outflows of forex deposits were reined in in March by the abovementioned regulatory means. Extra liquidity was also provided to credit institutions.

While retail deposits have since stabilized overall, confidence has remained fragile. Heightened uncertainty contributed to a substantial shift from long-term

¹² Mortgage credit is supported by a preferential state program providing interest rate subsidies to a wide range of households. It was originally to expire in July 2021, but was extended until end-2022.

¹³ The narrow definition of NPLs refers to the share of problem and loss loans in total loans, whereas the broad definition of NPLs encompasses the share of doubtful, problem and loss loans in total loans (according to CBR regulation no. 254). For further details see footnotes 3 and 4 in table 3 and Barisitz (2019; pp. 64, 70).

¹⁴ As of end-November 2021, state-owned banks accounted for about two-thirds of the sector's total assets. As table 3 shows, the three largest credit institutions were state-owned (Sberbank: 32.2% of total assets, VTB Bank: 16.6%, Gazprombank: 7.1%), followed by the largest private bank (Alfa-Bank: 4.6%), and another state-owned bank (Rosselkhozbank: 3.4%). The three largest EU-owned banks in Russia (Raiffeisenbank, Rosbank/Société Générale and UniCredit Bank) together made up about 3.6% of total assets and occupied, respectively, ranks 10, 11 and 12.

Table 2

Russia: recent banking sector data (2020–2022)

	End-2020	Mid-2021	End-2021	End-Jan. 2022	End-Mar. 2022 ⁹	End-June 2022	End-Sep. 2022
Credit risk							
Loans to enterprises ¹ (RUB trillion)	44.76	48.14	52.65	53.22	55.37	50.09	54.23
- real annual growth, exchange rate-adjusted (%)	4.8	4.4	3.1	3.0	-3.1	-6.0	-1.6
Loans to households ² (RUB trillion)	20.04	22.76	25.07	25.31	25.76	25.57	26.51
- real annual growth, exchange rate-adjusted, %	8.2	14.4	13.7	13.5	3.9	-2.9	-3.1
Mortgage loans (real annual growth, exchange rate-adjusted, %)	15.3	20.8	16.6	16.5	8.7	1.6	2.1
Share of mortgage loans in total household loans (%)	47.5	47.6	47.9	48.0	49.3	49.8	..
Consumer loans (real annual growth, exchange rate-adjusted, %)	3.7	9.9	10.8	10.6	-0.6	-7.1	-7.7
Share of consumer loans in total household loans (%)	48.4	46.8	46.5	46.4	45.3	44.9	..
Loans to state structures (RUB trillion)	0.81	0.62	0.46	0.41	..	..	..
NPL ratio (share in total loans, %, narrow definition) ³	9.0	8.4	7.1	7.1	..	..	..
NPL ratio (share in total loans, %, broader definition) ⁴	17.0	16.2	15.1	15.1	..	..	..
Market and exchange rate risk							
Forex loans (share in total loans, %)	17.9	15.8	15.7	16.2	..	..	..
Forex deposits (share in total deposits, %)	26.1	24.2	23.9	25.7	..	..	..
Liquidity risk							
Deposits of enterprises ⁵ (RUB trillion)	32.65	33.41	38.29	39.54	40.63	36.65	40.81
- real annual growth, exchange rate-adjusted (%)	10.5	9.1	8.9	9.9	1.5	2.6	9.6
Deposits of households ⁶ (RUB trillion)	32.83	32.38	34.70	34.20	33.27	32.94	33.14
- real annual growth, exchange rate-adjusted (%)	-0.7	-3.4	-2.5	-2.4	-12.9	-8.5	-8.8
Government deposits (RUB trillion)	3.99	8.26	6.26	6.55	..	..	..
Loan-to-deposit ratio (%)	94.4	96.6	98.6	98.3	..	..	..
Loan-to-deposit ratio (enterprises and households, %)	99.0	107.8	106.5	106.5	109.8	108.7	109.2
Banks' external assets ⁷ (share in total assets, %)	9.5	8.8	8.1	8.6	..	..	..
Banks' external liabilities ⁸ (share in total liabilities, %)	3.1	3.1	3.1	3.2	..	..	..
Profitability							
Return on assets (ROA, %)	1.7	2.1	2.1	2.1	..	..	..
Return on equity (ROE, %)	15.7	20.4	21.1	20.5	..	..	..
Shock-absorbing factors							
Capital adequacy ratio (capital to risk-weighted assets, %)	12.5	12.6	12.3	11.8	..	..	..
Tier 1 capital ratio (%)	9.7	10.3	9.6	9.2	..	..	..
Loan loss provisions (relative to total loans)	9.1	8.7	7.8	7.8	..	..	..
Memorandum items							
Total banking sector assets (% of GDP)	96.7	94.4	92.0	..	92.1	..	..
Total number of operating credit institutions	406	378	370	368	365	363	362

Source: Bank of Russia, in particular: various issues of "O razvitii bankovskogo sektora Rossijskoy Federatsii," "Statisticheskie pokazateli bankovskogo sektora Rossijskoy Federatsii," authors' own calculations.

¹ Corporate loans granted to nonfinancial organizations, individual entrepreneurs and financial institutions.

² Loans granted to individuals.

³ Share of problem loans (category IV) and loss loans (category V) in total loans (according to CBR regulation no. 254).

⁴ Share of doubtful (category III), problem (category IV) and loss loans (category V) in total loans (according to CBR regulation no. 254).

⁵ Funds of corporate customers (nonfinancial organizations, individual entrepreneurs and financial institutions).

⁶ Funds (deposits) of individuals.

⁷ Funds (including correspondent accounts with banks and securities acquired) placed with nonresidents.

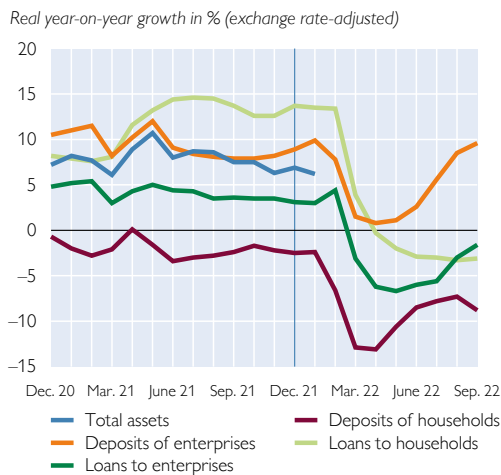
⁸ Funds raised from nonresidents (including deposits of legal entities and individuals).

⁹ From end-February 2022, the CBR has not published some important prudential indicators, like the NPL ratio, share of forex loans, banks' external assets, profitability, capital adequacy, loan loss provisions.

to short-term household deposits in the spring of 2022. Some deposit flows from sanctioned (SWIFT-excluded) to unsanctioned banks, including EU-owned significant banks, have also been registered and undermine the lending capacity of sanctioned banks (Litova, 2022). That said, oil price rise-triggered growth of government revenues reportedly led to a strong increase in public sector deposits in March (BOFIT Weekly, 2022a). The move to short-term deposits was mostly reversed over the summer. On the other hand, the badly organized partial

Chart 1

Growth rates of banking sector assets, deposits and loans



mobilization in September to October reportedly triggered deposit withdrawals of around RUB 500 billion (about 1.5% of total retail deposits) before the situation calmed down somewhat in late October/early November. Lending in foreign currencies (notably in US dollar and euro) has declined in recent months and some banks have converted existing forex loans to ruble loans (Ekonomika i Zhizn, 2022; p. 4). The share of forex deposits in total deposits reportedly declined from about a quarter before the war to 12% at end-August 2022 (BOFIT Weekly, 2022b). Overall, on a year-on-year basis, by end-September the growth of loans to enterprises (-2%) as well as to households (-3%) was negative (in real terms and exchange rate-adjusted),¹⁵ while

enterprise deposits continued to expand (10%, probably helped by inflows from oil and gas firms and/or state-owned firms) (Bank Rossii (ed.), 2022e; p. 2), and retail deposits strongly declined (-9%) (as shown by table 2 and chart 1).

Given at least temporary financial stabilization – notwithstanding persistently high inflation – the gradual reduction of the key rate between March and June back to its pre-war level of 9.5% and, beyond that, to 7.5% in September, may have helped borrowers but was certainly insufficient to restore lending activity, given the Russian economy's unfolding recession. The government, in cooperation with the monetary authority, therefore launched subsidized lending programs focusing on systemically important enterprises, trade corporations, the agroindustrial complex and SMEs, in addition to existing mortgage credit subsidies which were adjusted in late June with interest rate caps lowered from 9% to 7%. Repayment holidays for distressed borrowers, discontinued in mid-2021, were resumed and have met substantial demand.

Nonetheless, the deepening recession and foreign exchange operations¹⁶ are reportedly responsible for Russia's banks chalking up a loss of RUB 1.5 trillion (about USD 25 billion) in the first half of 2022. That represents about 12% of the sector's regulatory capital as of end-2021 or around 1.3% of its total assets, with the sector going into the red for the first time in seven years. Most loss makers are relatively large players: Five of the thirteen systemically important credit institutions reportedly made losses in the first six months (see table 3), while eight were profitable, as were the overwhelming share of medium-sized and small banks (Bank Rossii, 2022f). Some minor recapitalization measures totaling about

¹⁵ Overall, (subsidized) mortgage loans were the only credit category that still featured a positive (+2.1%) growth rate in September (year on year).

¹⁶ The latter included transactions with derivative financial instruments (mostly swaps, forward dealings and futures contracts) against the backdrop of the yo-yoing exchange rate and the exceptional financial instability of early spring 2022. Meanwhile, banks' net interest income in the first half of 2022 only declined 5% (year on year).

Table 3

**List of systemically important credit institutions according to CBR
(as of December 1, 2021)**

Rank	Bank name	Ownership	Assets	Share of total banking assets
			RUB billion	%
1	Sberbank	State	37,500	31.5
2	VTB Bank (Vneshtorgbank)	State	19,300	16.2
3	Gazprombank	State (indirect)	8,300	7.0
4	Alfa-Bank	Private (domestic)	5,400	4.5
5	Rosselkhozbank (Russian Agricultural Bank)	State	4,000	3.4
6	Moskovsky kreditny bank (Credit Bank of Moscow)	State	3,400	2.9
7	Bank Otkrytie	State	3,100	2.6
8	Sovcombank	Private (domestic)	1,800	1.5
9	Promsvyazbank	State	n/a	n/a
10	Raiffeisenbank	Private (foreign)	1,500	1.3
11	Rosbank (Société Générale)	Private (foreign)	1,500	1.3
12	UniCredit Bank	Private (foreign)	1,200	1.0
13	Tinkoff Bank	Private (domestic)	1,100	0.9

Source: Bank of Russia (2022; p. 37).

USD 3.5 billion, relating to state-owned banks such as Gazprombank and VEB (Vneshekonombank, a development bank), and financed by the NWF, have already been carried out in recent months.

In 2021 and early 2022, some important and promising bank privatization efforts were made, which were unfortunately only partly successful. After nationalizing and restructuring the Aziatsko-Tikhookeansky Bank (ATB, Asian-Pacific Bank), a medium-sized credit outfit, through the CBR-owned Banking Sector Consolidation Asset Management Company, the ATB was successfully sold to a Kazakh strategic investor for USD 180 million in fall 2021. The next step should have been the sale of nationalized and restructured Bank Otkrytie,¹⁷ the country's seventh-largest credit institution in terms of assets in late 2021 (see table 3). Privatization negotiations with a prominent Italian investor had reached an advanced stage in January 2022, when deepening geopolitical tensions, Russia's attack on Ukraine and Western sanctions imposed on Otkrytie itself forced the CBR to put off the sale.¹⁸

Furthermore, two recent institutional adjustments are highly relevant for banks: after a first wave of Western sanctions were imposed on Russia in the wake of the country's annexation of Crimea in 2014, the CBR developed the SPFS (Systema peredachi finansovykh soobschenii, or System for the Transfer of Financial Messages). By 2018, almost all Russian banks had adopted the transaction system. This helped SPFS take the place of SWIFT for domestic payments of banks excluded by Western sanctions in early 2022. Yet, according to the CBR, SPFS possesses

¹⁷ For more information on Otkrytie's past turbulences and resolution see Barisitz (2018; pp. 61, 63–64).

¹⁸ In late April, the CBR put forward a new plan, not to privatize but to merge Otkrytie with state-owned VTB (Vneshtorgbank, Russia's second-largest bank) and its former subsidiary, RNKB (Rossisky natsionalny kommerchesky bank/Russian National Commercial Bank), which is focused on serving the Crimean peninsula annexed from Ukraine in 2014. The CBR's proposal apparently received the go-ahead from President Putin (Financial Times, 2022b).

links with 70 foreign banks in only twelve countries, including Belarus, making it an only partial SWIFT replacement for Russian players.¹⁹

From 2014 to 2017, moreover, the CBR developed the Mir card payment system for electronic fund transfers. The authorities mandated that all state welfare and pension payments be processed through the system by 2018, which boosted the acceptance of Mir cards. As of end-2021, 87% of the Russian population possessed a Mir card, which was the principal means of payment for 42% of people (Teurtrie, 2022; p. 26). When Visa and Mastercard exited Russia under the impact of Western sanctions in 2022, all cards from these international payment systems issued by Russian banks continued to operate for domestic transactions, but cross-border transactions were no longer available. Mir's market share subsequently expanded sharply and there was reportedly little disruption of payments made inside Russia, although Mir's international links are likewise less developed and partly focused on Russian tourist destinations.²⁰

2 EU-owned significant banks are fundamentally revising their strategy and activities in the Russian market

The Russian war in Ukraine and Western sanctions strongly increase risk levels for EU-owned significant banks operating in Russia, namely Raiffeisenbank Russia, UniCredit Bank Russia and Rosbank/Société Générale.²¹ The prospect of intensifying sanctions risks, shrinking foreign investments and high recessionary pressures means a decisively more challenging environment than anticipated before the war. The war and sanctions undermine the different customer segments of EU-owned significant banks, although risk models may not fully reflect these specific risk factors. The risk-taking capacity of European parent institutions for Russian direct and indirect exposures is also starkly reduced. This situation can nonetheless be partially offset by temporary profitability boosts, such as from net fee and commission income generated by increasing demand for forex-related transactions, from trading-related income or income derived from high deposit inflows in a context of increased demand²². EU-owned significant banks have different profitability trajectories in 2022.

¹⁹ According to Vice-Governor Skorobogatova, the number of SPFS participants grew from 389 companies and banks at end-2021 to 453 at end-May 2022 (about 4% of the total number of participants in SWIFT) (Interview Olga Skorobogatovoy agentstvu TASS, 2022).

²⁰ At end-March 2022, the number of Mir and Mir-compliant cards in circulation reportedly exceeded 125 million. Outside Russia, in the spring of 2022 Mir cards were accepted in Armenia, Belarus, Kazakhstan, Kyrgyzstan, Tajikistan, Türkiye, the United Arab Emirates, Uzbekistan and Vietnam (Mironline (ed.), 2022). In July 2022, Iran also decided to join the Mir card system and ATMs in Cuba started to accept Mir cards (Kurier, 2022; Interfax, 2022a). However, following threats of US sanctions in September 2022, some important Turkish, Kazakhstani, Uzbekistani and Vietnamese banks recently suspended operations with Mir cards (Pitel, 2022; Russland Aktuell, 2022).

²¹ To measure the different components of EU-owned significant banks' exposures in Russia, the most relevant items are local equity, loans (local exposures and via the parent institution), liquidity and funding (including intragroup) and off-balance sheet items (such as derivatives or certain types of guarantees). Banks having a multiple point of entry (MPE) resolution strategy were incentivized to clearly separate local operations from their mother company (e.g. regarding their funding or IT infrastructure), although some interdependencies remain.

²² As an impediment to benchmarking, publication of some of the previously disclosed financial indicators stopped in Russia from February 2022 onward, limiting the possibility of quantitative comparisons in the local market for the different quarters of 2022. For EU-owned significant banks IFRS financial data published on Russian activities is a relevant alternative.

While their rise remained moderate during the pandemic, impairments of EU-owned significant banks have noticeably increased in the context of the war, reflecting worsening risk levels, especially regarding credit and sanctions risks. In the first half of 2022, Russia-related impairments represent a significant share of overall provisions of parent institutions²³ and deviate from sectoral trends. Impairment policies (and their conservatism) differ between banks and are impacted by management overlays. Asset quality deterioration and asset valuation discounts also generate higher risk-weighted assets requirements (which have tended to double compared to 2021), along with forex- and liquidity-related effects. At the same time, capital considerations have become central in the context of the war. EU-owned significant banks have kept sufficient and adequate capital levels in the recent past, including in 2020 and 2021 and analysis of worst-case scenarios disclosed by EU-owned significant banks reveals that capital impacts are significant but can be absorbed (with assumptions simulating the loss of equity participation, debt, intragroup, cross-border and derivatives exposures, with different degrees of recoverability and off-setting impacts²⁴). Additional ECB projections premised on a severe loss of cross-border exposures and local banking activities (including intragroup funding and equity) also confirm the ability of these banks to remain compliant with capital requirements²⁵ despite such shocks (Mazany and Quagliariello, 2022).

Complying with the successive waves of new strict and rapidly evolving sanctions raises operational constraints for EU-owned significant banks, while the consequences of noncompliance are deterrents (including potential fines and reputational risks).

In retaliation to Western sanctions, Russian countersanctions include new restrictions on foreign assets or on the capacity of foreign players to act on the Russian market (including local capital markets). This approach also raised concerns about nationalization risks (which have the potential to concern EU-owned significant banks but have not materialized so far), confiscation and transfer risk. In a context of high uncertainties and increasing reputational risks (with unprecedented pressure from public opinions and financial markets), some foreign companies, including a wide range of economic actors from retail or industrial players to specialized financial services providers like auditing firms, have adopted “self-sanctioning” and exited the market of their own accord.

In the context of the war, EU-owned significant banks need to reconsider their strategy, contingency and business plans defined in peacetime. Pre-war, they were expected to engage in selective risk-taking to preserve asset quality in the aftermath of the pandemic, embrace cost discipline with restructuring measures, and move forward on digitization with more services. The sharp worsening of risks requires

²³ *Russia-related risks have also triggered a market price correction for the parent institutions of EU-owned significant banks active in Russia and sector-wide. It is notable moreover that, when it comes to exposure levels, these banks represent the most material risk for the European banking sector (compared with less material exposures at parent institution level).*

²⁴ *Off-setting impacts to capital loss scenarios include the RWA relief coming from lost exposures, RUB appreciation effects and the result of de-risking actions (exposure reduction, portfolio disposals, coverage by collateral). Internal capital generated and not distributed as dividends due to local restrictions provides an additional buffer.*

²⁵ *More broadly, specific European stress test projections in the form of a vulnerability analysis also confirmed the capacity of euro area banks' capital to resist negative impacts from exposures to vulnerable sectors, worsening macrofinancial conditions and market-related revaluation risks (ECB, 2022; p.74).*

adequate management of the new challenges in close liaison with parent institutions and banking supervision authorities, which have developed a comprehensive framework at the European level to address the impacts of the war and sanctions for banks (Mazany and Quagliariello, 2022).

In the months before the war some EU-owned significant banks considered expanding further into the Russian markets (with reported interest in banking entities or portfolio acquisitions). This approach was completely reversed after the war in Ukraine broke out, at a time when the market valuation of these was also undermined by the war. The three EU-owned banks qualifying as significant institutions in the Russian market initiated different forms of disengagement strategies. Players either implemented or considered exit strategies, echoing the acceleration of withdrawal initiatives observed for less significant European and American institutions still active in Russia. Concrete actions taken include strong restrictions on new lending (up to freezes), de-risking initiatives and a substantial reduction in cross-border activities.

With the most advanced exit strategy, Société Générale announced in May 2022 that it had completed the sale of Rosbank to a local investor for a loss of around EUR 3.2 billion, negatively impacting the Group's profitability but with a limited capital impact of less than 10 basis points. The parent institutions of Raiffeisenbank Russia and UniCredit announced they were reviewing exit options in an ongoing process. In general terms, such options can take different forms, for instance with a wind-down strategy, a sale (to a local or foreign investor, or partially involving local management), or a deconsolidation via a "bad bank" special purpose vehicle, which all have both advantages and disadvantages. In July 2022, Russian officials indicated that, in the current environment, they would block the sale of foreign banks active in Russia and review any disposal plan case-by-case.

A key consideration regarding such disposals is value preservation. EU-owned significant banks in Russia remained fairly profitable in the years before the war, although with various levels of performance and material impact on the Group's risk profile (from low to medium). The higher the share of Russian activities in overall profits or total capital, the more sensitive exit strategies become, especially as uncertainties are very high on the medium-term outlook and the next stages of the conflict. As such, EU-owned significant banks can consider options that would avoid a full write-off of Russian operations. Those remaining active on the Russian market can also have certain competitive advantages compared to local peers (not being directly subject to sanctions and ties with parent companies which have broader access to international markets) and can position themselves as key partners for European investors that have not fully exited the market. However, there is a reputational risk of negative coverage (from the press, rating agencies or investors) and public pressure for not leaving as the country gradually becomes a war economy.

3 Risks and shock-absorbing factors

After projecting GDP drops of 10% to 15% in spring, many institutions have considerably scaled back their forecasts of the depth of the Russian recession in 2022 while now expecting the recession itself to be more protracted and substantially affect 2023. The IMF adjusted its GDP forecast for Russia for 2022 from -8.5% in March to -6% in July and -3.4% in October; at the same time it

changed its 2023 forecast from -2.3% to -3.5% and (back) to -2.3% . The Vienna Institute for International Economic Studies (wiiw) expects a recession of -3.5% in 2022, followed by a further contraction of -3% in 2023.

These changes are largely due to the authorities' unexpectedly successful (at least temporary) stabilization of the financial sector and the ruble in the weeks following the major initial onslaught of the sanctions in late February and early March 2022. Moreover, the authorities also front-loaded a drive to diversify their energy exports away from Western countries in April to June and made some headway (as mentioned above), although the decisive test will come in late 2022, when the EU has resolved to stop 80% to 90% of its oil imports from Russia (except via pipelines). If actually carried out in the coming late fall/winter, this ban will probably have an appreciable impact on the Russian economy. This blow and a possible global recession or stagnation, perhaps exacerbated by a further retaliatory squeeze on remaining Russian gas deliveries to the EU, may explain Russia's likely continued, if milder, recession in 2023.

The key rate, which was high throughout most of spring 2022, cut demand for credit. Moreover, ongoing or completed withdrawal from Russia by many foreign investors dampened credit demand. While the key rate was subsequently reduced beyond even its pre-war level in summer 2022, which should support resumed lending, the sanctions-triggered downswing since April, production disruptions and high uncertainty are having the opposite effect and continue to erode the basis for credit demand.

Credit risk will therefore become more pronounced as the recession further unfolds in late 2022, directly through sanctions-triggered production, sales and revenue disruptions²⁶ and indirectly through the recessionary impact on borrowers and demand.

For EU-owned significant banks, a credit risk deterioration is likely across segments and regions, as the different components of their credit portfolios are impacted, ranging from domestic retail customers to nonretail counterparties (Russian and international). In parallel, for parent institutions, new regulatory caps regarding the amount of money Russian nationals (nonresidents) can hold as deposits in the European Economic Area may further limit flows with Russian clients. Overall, increasing credit and sanctions risks are grounds for a further increase in loan loss and sanctions-related provisions, depending on the levels already booked proactively at the outset of the war (to anticipate risk at managerial level in Q1 and Q2 2022 as some banks front-loaded material provisions). In turn, this may reduce profits and negatively impact ROE, cost-income ratios and dividend payment capacities. As per available projections, EU-owned significant banks have enough capital to absorb further losses. Nevertheless, the introduction of dividend bans by Russian authorities means that profits made by these banks cannot be taken out of Russia, while war-driven restrictions strongly limit potential support from parent companies in case of difficulties. This situation has the potential to block

²⁶ Some of these disruptions have (so far) been marginally softened by Russia's new policy of legalizing "parallel imports" of sanctioned products – via alternate channels, typically retail trade, without permission of trademark owners – in response to sanctions. In the period from mid-May to end-August 2022, for instance, such parallel imports came to about USD 9.4 billion, according to estimates of the Federal Customs Service. In September, industry minister Manturov forecast parallel imports to top USD 20 billion at end-2022 (RIA Novosti, 2022).

capital flows abroad in the medium term, and to become a structural factor and a performance differentiation factor with local peers over time.

Regarding interest rate risk, the CBR pointed out, as it announced its September 2022 key rate cut and again confirmed in October, that its cycle of loosening may have come to an end, given the shift in the balance of deflationary and inflationary risks toward the latter and continued high inflationary expectations. Further, the risk remains that Russian producers' search for new suppliers or logistical chains or rising demand for domestic production given restrained import possibilities could push up inflationary pressures. That could trigger an upward key rate correction and, in turn, dampen lending activity.

Exchange rate risk is currently less of a problem, given that energy prices are high and the ruble is, in any case, no longer fully convertible. But exchange rate risk, including possibly heightened volatility, might become a problem in 2023, following the substantial expected further tightening of the EU's oil purchase restrictions from late 2022 (as mentioned above). Likely weaker overall Russian oil exports as a result,²⁷ coupled with a degree of recovery of imports (after a reorganization of some supply chains), could put pressure on the ruble in 2023. This might exceed the "corrective" depreciation that some government or industrial groups would favor anyway to ease pressures on the budget and facilitate import substitution (Bank Rossii, 2022c).

For EU-owned significant banks and parent institutions, foreign currency risks remain a key risk requiring adequate management using hedging strategies which are increasingly expensive and complex given possible ruble volatility or increased scarcity of hedging products. The overall risk situation is also heightened by the perspective of second-order effects on top of direct impacts. These banks can have exposures to international players dependent on activities with Russia and Ukraine (in terms of revenues, energy or supply chain) or to sectors which are particularly vulnerable in the context of the war and in the aftermath of the pandemic. From a credit risk perspective, certain counterparties are likely to be negatively impacted by the deteriorating macro environment with slower growth, high prices (especially energy prices), higher debt yields and a loss of confidence among economic actors (reducing consumption or investment levels). Potential contagion effects related to global markets are to be anticipated. Market risk considerations come alongside higher funding costs or enhanced volatility for certain market products like commodity derivatives. Climate and environmental risk are also becoming more critical in bank loan books given disruptions in the energy sector, the search for short-term solutions to energy shortages (which can increase fossil fuels production and consumption) and the shift toward a "war economy" in Russia and Ukraine with a lesser focus on environmental footprint.

Concerning shock-absorbing factors, Russian banks went into the current crisis with a capital adequacy ratio of 11.8% at end-January 2022, which is relatively

²⁷ *Meanwhile, in recent months Russia has been striving to swiftly redirect some of its oil exports to non-Western destinations, including China, India and Türkiye. For example, in May 2022, Russia displaced Saudi Arabia as the top crude oil supplier to China, and Russia advanced to become India's second-largest oil supplier (following Iraq) (Murtaugh and Chakraborty, 2022). Whereas in February 2022, the EU and Britain still accounted for 53% of Russia's total crude oil deliveries, this share fell to 21% in October, while emerging, primarily Asian, countries' share (including China, India, Türkiye and others) expanded from 30% in February to 76% in October. Total Russian monthly oil exports increased from 3.0 to 3.3 million barrels per day in this period (Le Monde, 2022b).*

weak compared to other economies of Central, Eastern and Southeastern Europe (CESEE). That said, as table 3 shows, the largest players are state-owned and therefore possess an implicit state guarantee. Loan loss provisions in early 2022 covered NPLs as narrowly defined. The overall loan-to-deposit ratio was quite moderate at 98% (as of end-January 2022)²⁸. At end-2021, the regulatory capital of the banking sector came to about RUB 12.6 trillion (or approximately USD 165 billion, capital adequacy ratio: 12.3% – see table 3). Moreover, according to the CBR, banks' accumulated capital cushions, taking into account various buffers, including macroprudential ones, came to around RUB 7 trillion (USD 90 billion to USD 95 billion), or more than half of overall capital (Bank Rossii (ed.), 2022b). Given the loss figures of the first half of 2022 (RUB 1.5 trillion) and a lack of more detailed information, a simplified argument could be made that more than one-fifth of that capital cushion had evaporated by mid-2022, and erosion is continuing. Overall, the CBR, in the second quarter, perceived the sector's loss of about half of its capital by end-2022 under the impact of the unfolding recession and sanctions as a "likely scenario," which however "does not raise concern" given that "there is a margin of safety" and that the authorities plan to "support lenders if necessary" (Interfax, 2022b; Bank Rossii, 2022f).²⁹

While the capital cushion exceeding the minimum ratio appears sizable, it is distributed unevenly across the sector, and a major crisis like the current downswing will very likely require CBR support measures for at least some players.³⁰ In late July 2022, the CBR pointed out that restructuring activities showed a substantial number of debtors experiencing repayment difficulties, which pointed to expanding NPLs and provisioning needs which in turn weighed on capital adequacy. In the of summer of 2022, the CBR reportedly carried out a detailed preliminary analysis to study possible recapitalization variants with the government, which would also enhance banks' lending potential (Ekspert, 2022).³¹ As of mid-November, the CBR stated that "negative financial results of the banking sector have declined in recent months" – without substantiating, while "the year 2022 as a whole will hardly yield a profit" (TASS, 2022).

Another at least theoretically cushioning factor is credit institutions' net external assets, representing around 5% to 6% of total assets. However, the share of these assets currently inaccessible because of freezes is not clear. Russia's accessible international reserves (those not placed in Western jurisdictions) currently stand at about USD 252 billion or 14% of GDP (see above). These have of course been starkly diminished since the freezing of almost half of the original amount of USD 630 billion in late February. Yet given the high current energy prices, Russia has most recently been able to earn tens of billions of dollars of fresh

²⁸ The loan-to-deposit ratio for enterprises and households only (i.e. disregarding the government sector) was 109% at end-September and thus only three percentage points higher than in early 2022 (see table 2).

²⁹ The regulatory minimum capital (own funds) adequacy ratio (N1.0) for credit institutions in Russia is 8.0%, the minimum tier 1 capital ratio (N1.2) is 6.0% (CBR regulation no. 646-P, dated July 4, 2018). It should of course be noted that in the reinstated regime of regulatory forbearance valid from end-February 2022, actual bank compliance with capital ratios is no longer stringently measurable.

³⁰ A European Commission assessment of late June 2022 appeared to be more pessimistic, however, and considered about half of Russia's banks to be in need of recapitalization (information from John Berrigan, EU Commission).

³¹ As mentioned above, some smaller recapitalization measures of state-owned banks have already been taken.

revenues³². The authorities also stand to benefit from the NWF and its liquid assets of about 6% of GDP at the disposal of the CBR (also see above).

Notwithstanding recent inflows of sizable forex-denominated public proceeds, Russia defaulted on its foreign debt on June 27 (Bloomberg, 2022). This was due to the authorities being rendered technically unable to forward bond repayments to creditors in US dollar due to sanctions. While the consequences of this technical default are not yet clear, punitive measures have already excluded Russian access to Western financing and the country has done without such access for years. In any case, Russia's general government gross debt remains at a very modest level of GDP (16% to 17%) compared to most advanced economies.

The picture is completed by Russia's strong fiscal and current account positions achieved in the first half of 2022. While the current account surplus may reach a record level this year (due to continuing high energy prices and a contraction of imports triggered by sanctions and recession), the deepening economic downturn in the third and fourth quarters will probably push the budget into the red. The Ministry of Finance views a year-end federal budget deficit of up to 2% of GDP as possible.

4 Outlook: banks can cope in the short term, major risks lying ahead

Although faced with severe Western sanctions, Russian authorities and banks can cope in the short term. Yet, major risks are lying ahead and European players are at a crossroads. The authorities still appear financially prepared to support the economy and banks through the pronounced recession in 2022 and a probable further contraction in 2023. This will apply even if banks lose up to 50% of their capital due to the crisis – something reported as likely by the CBR a couple of months ago. That said, still ample government financial means will likely soon be dented by the impact of the imminent EU oil embargo. What is more, oil and gas money cannot help circumvent Western technology or banking sanctions. In any case, Sberbank felt compelled in mid-May to sell off large parts of its “ecosystem,” into which it had invested major resources over years, to a tiny little-known company in order to protect its digital services from US sanctions.³³ With this company, Sberbank intends to “maintain partner-like relations in the realization of marketing and operational activities” (Korolev et al., 2022). This may be just one example of economic costs and losses some leading Russian banks, firms and entrepreneurs may have to sustain from now on.

The outlook for the Russian banking sector and EU-owned significant banks will be sensitive to the next phases of the Russia-Ukraine conflict. A consolidation tendency around larger state-supported players appears likely. Available projections show a capacity for EU-owned significant banks to resist further shocks, especially from a capital perspective. Escalation scenarios could nonetheless increase economic damage, vulnerabilities and second-order effects generated by the war and sanctions. Additional cuts to Russian energy flows to Europe are a key risk, and their financial consequences would depend on the price and availability of

³² Federal oil and gas revenues from late February to end-September 2022 exceeded USD 95 billion (*Ekonomicheskaya Ekspertnaya Gruppy*, 2022c; pp. 23–24).

³³ The company's name is “Novye vozmozhnosti.” It was established in March 2022, information on its CEO and shareholders is classified under Russian law (see also Allinger et al., 2022; p. 58).

alternatives. At the same time, a scenario with a sudden or step-by-step easing of tensions would have positive impacts, although it appears less likely at the moment. Beyond the benefits of peace, it would reduce recession risk, facilitate post-pandemic recovery and offer the perspective of certain sanctions being lifted over time. The probability of these different options will have to be included in the new strategies defined by the remaining EU-owned significant banks, which have disclosed that they are considering all options, including exiting the Russian market.

Overall, Russia's war in Ukraine represents a paradigm shift given a large share of previously identified threats (in the pre-war period) that materialized in a short period of time, while emerging risks like cyber risk and to a certain extent climate and environmental risks have intensified. Moreover, the war in Ukraine and related Western sanctions do not only have regional consequences (such as impacting the capacity of EU-owned significant banks to operate in their local environment and leaving the banking sector exposed to second-order effects): they also darken the outlook for the global economy with slowing growth, increasing inflationary pressures and disrupted trade flows (including in key sectors like energy, commodities and technology). A further decoupling between Europe and Russia, which seems to be looking to build closer economic and energy ties with alternative partners in Asia and elsewhere, could make the war a turning point with wide-ranging economic, financial and geopolitical consequences in the medium term.

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