MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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1. CAPITAL CONTROL STABILIZED THE SITUATION ON THE CURRENCY MARKET

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In late February 2022, the EU countries and the USA put in place sanctions against the Bank of Russia, which imply freezing of international reserve assets. As a result, about 50% of the reserves ($300 bn of the $630 bn available as of February 1, 2022) were affected by the sanctions.

Countries whose international reserves were previously frozen (Iran, Libya, Syria, etc.) experienced a large-scale weakening of their national currencies and a significant acceleration of inflation. At the moment in Russia these processes were limited thanks to anti-sanctions measures, primarily tough restrictions on capital movement.

The measures taken by the Bank of Russia in the context of the reserves freeze are in line with global practice. Nevertheless, the Russian situation is in many ways unique, as the Bank of Russia adheres to the inflation targeting regime and actively used interest rate policy in response to negative shocks. Central banks in other sanctioned countries adhered to a managed exchange rate regime. Thus, the Bank of Russia has a more flexible toolkit for counteracting shocks.

The freezing of reserves led to the suspension of the budget rule. Accordingly, despite the reduction of exports, the price growth on key commodities led to a sharp increase in the supply of foreign currency on the Russian foreign exchange market, while demand remains limited due to the effect of restrictions on capital flows. In the medium-term period, as a new equilibrium is established in the markets, it is advisable to develop an alternative version of the budget rule, ensuring, as before, a lower correlation between oil prices and the exchange rate.

On February 27, 2022, the countries of the European Union and the USA introduced sanctions against the Bank of Russia, which imply freezing of some international reserve assets. As a result, about 50% of the reserves ($300bn of the $630bn available as of February 1, 2022) were affected by the sanctions. This was a new challenge for the Russian foreign exchange market in Q1 2022.

International reserves (reserve assets) are highly liquid foreign assets available to a country's monetary authorities. The following main functions of international reserves are usually distinguished:

- Countering balance of payments shocks by means of operations on the foreign exchange market;
- Maintaining the foreign exchange market liquidity;
- A signal function for economic agents regarding the ability of the monetary authorities to withstand shocks at the currency market, i.e. a guarantee of macroeconomic stability (sufficient stocks of international reserves characterize an economy's potential to fulfill its global obligations).

In countries with a fixed exchange rate, reserves help to maintain the exchange rate within certain limits, which was more relevant for Russia until 2015. In countries with a free-floating exchange rate, reserves are used to smooth sharp shocks in the foreign exchange market and perform primarily a signal function.

The freezing of international reserves resulted in an accelerated outflow of capital from foreign institutional investors and a weakening of the ruble. Amid investors' panic moods, on March 11 the ruble-to-dollar exchange rate hit the historic minimum of Rb120.4 to the dollar, which corresponds to the depreciation by 55.4% against the beginning of February 2022. Nevertheless, by the end of Q1 2022, the ruble strengthened up to the pre-crisis level.

In the first days after the announcement of the international reserves freezing, Russia's sovereign rating was downgraded by international rating agencies (by S&P by eight notches and by Moody's and Fitch by six notches at a time).[1] Although the downgrade of the sovereign rating is explained not only by the freezing of the Bank of Russia's assets, but also by the overall growing sanctions pressure, the significant amount of reserves served as a guarantee of Russia's creditworthiness as a borrower with limited access to long-term financing in foreign markets since 2015. The loss of the signal function of international reserves, as well as the plunge of the sovereign rating to "extremely speculative" speeded up the decision of institutional investors (the Norwegian pension fund KLP,[2] the UAE sovereign fund Mubadala[3]) to suspend investments in Russia in the context of the general increase of reputational risks of these investments.

As the world experience demonstrates, the freezing of the Bank of Russia assets has previously been applied to Iran (November 1979 – 1981, February 2012 – January 2016, September 2019 – to date), Libya (March 2011 – December 2011), Venezuela (April 2019 – to date), Syria (November 2011 – to date), North Korea (July 2006 – to date), and Afghanistan (July 1999 – January 2002, August 2021 – to date). As a rule, such tough sanctions have been applied in connection with armed conflicts, political crises, and the development of nuclear weapons (*Table 1*).

Most of these countries had an inflexible exchange rate mechanism, involving the active participation of the monetary authorities in exchange rate management. Foreign exchange interventions were the key function of international reserves for most of these countries. Therefore, freezing of international reserves had significant consequences primarily for the foreign exchange market, putting strong pressure on the exchange rate when the ability to maintain it by means of foreign exchange interventions was limited. This distinguishes the experience of these countries from the Russian one, which is characterized by the inflation targeting regime and the free-floating exchange rate, which allows using the interest rate as the main instrument of monetary policy. The inverted yield curve of Russian financial instruments (long rates are much lower than short ones) in the current environment acts as a positive signal that economic agents expect inflation and exchange rate stabilization, as well as a decrease in the key rate of the Central Bank of Russia in the medium term. This indicates higher confidence in the monetary authorities today compared

1 URL: http://www.worldgovernmentbonds.com/credit-rating/russia/
2 URL: https://www.reuters.com/article/ukraine-crisis-norway-klp-idCNL8N2V36BV
3 URL: https://www.bloomberg.com/news/articles/2022-03-28/abu-dhabi-wealth-fund-pauses-investments-in-russia-reuters-says

1. Capital control stabilized the situation on the currency market

Table 1

Cases of freezing of international reserves

Country	Reserve freeze period	Explanations
Iran	November 1979 – 1981, February 2012 – January 2016, September 2019 – to date	1979 Islamic Revolution. Subsequent sanctions related to Iran's missile and nuclear development programs.
Venezuela	April 2019 – to date	Sanctions against the Nicolas Maduro regime. Tougher sanctions in the form of freezing of reserves are associated with another political crisis in Venezuela in 2019.
Libya	March 2011 – December 2011	Political, ideological and military confrontation between Libya (the Gaddafi regime) and Western countries, escalating into a military invasion of Libya.
Afghanistan	July 1999 – January 2002 (sanctions against the CB were lifted)	Assisting the Taliban (an organization banned in Russia) in military operations against the U.S.
	August 2021 – to date	The fall of the Afghan government, the takeover of most of Afghanistan by the Taliban (an organization banned in the Russian Federation).
Syria	November 2011 – to date	Civil war in Syria (anti-government demonstrations since March 2011), accusations of human rights violations, violence and repression against civilians by the authorities.
North Korea	July 2006 – to date	Nuclear weapons testing.

Source: Own compilation.

to the 2015 crisis, when the yields of long financial instruments during the crisis significantly increased.

Inflation targeting regime implies that in a crisis situation on the foreign exchange market, taking into account significant exchange rate pass through, monetary authorities should also limit ruble exchange rate fluctuations in order to achieve the inflation target and maintain financial stability. Increasing interest rates when the ruble is weakening ensures convergence of returns on ruble and foreign currency instruments, stabilizes the situation on the currency market and restrains the outflow of ruble deposits from the banking system. It should be noted that the episode of the ruble's initial weakening and its subsequent recovery to previous values after the reserve freeze is unique in terms of global experience. Foreign currencies depreciated during the first month of the reserves freeze usually stabilized at a new (weaker) level. The strengthening of the ruble, in addition to an increase in the key rate, was primarily due to restrictions on capital flows, which reduced the demand for foreign currency, while its supply went up amid rising prices for major Russian exports.

International experience also confirms that the introduction of rigid restrictions on capital movement while restraining the growth rates of money supply makes it possible to smooth the depreciation of the national currency. At the same time, further development of the situation at the currency market is determined primarily by the trade balance, i.e. export and import movement. In such a situation capital control measures may tighten or weaken depending on the development of the market situation, partly playing the role of international reserves, though remaining a much less "precise" instrument.

Countries facing a freeze in international reserves gradually switched to international settlements in third-country currencies. For example, in 2012–2013 there was a significant increase in payments for Iranian oil exports in South Korean won and Chinese yuan.[1] In 2020, the biggest share of the turnover in

1 Central Bank of the Islamic Republic of Iran // Annual Review. 2012. No. 13. P. 1391.

Iran's domestic official currency market was taken by the yuan – 26.7%, the share of the euro dropped markedly to 26.4%, the share of the UAE dirham – 17.0% and the Turkish lira – 6.5%, the share of transactions in other currencies surged and hit 23%.[1]

In a number of countries, one of the consequences of the foreign exchange reserve freeze has been the emergence of a system of multiple exchange rates. For example, from September 2012 to July 2013, the Iranian rial was traded at three different exchange rates: the central bank exchange rate for imports of priority goods; the central bank exchange rate for sales of proceeds from oil exports and imports of other priority goods; and the flexible exchange rate for sales of non-oil exports and imports of all other goods. Subsequently, the first two exchange rates were unified into one. The dual system of exchange rates (official and market exchange rates) also exist in Venezuela.

Despite the financial markets stabilization, the sharp decline in the available part of international reserves could not but affect their ability to perform their basic functions. The freezing of part of international reserves led to a decline in their adequacy as measured by generally accepted indicators. According to some of the criteria presented in *Table 2*, unfrozen foreign exchange reserves ceased to be sufficient to neutralize the effects of a set of macroeconomic shocks, as well as to simultaneously finance imports for the next 3 months and make payments on the foreign debt for the next 12 months.

Table 2

Compliance with the Bank of Russia international reserve sufficiency criterion in Q1 2022

Criterion of sufficiency of international reserves	How many times the actual value of reserves exceeds the sufficiency criterion			
	Reserves, total	Currency reserves	Unfrozen reserves, total	Unfrozen currency reserves
(1) Financing three months of imports	6.7	5.3	3.3	2
(2) Financing of external debt payments within 12 months (Guidotti criterion)	4.6	3.6	2.3	1.3
(3) Sum of criteria (1) and (2) (Reddy's criterion)	2.8	2.1	1.4	0.8

Source: Own calculations based on data released by the bank of Russia and expert estimates.[2]

In addition to declining sufficiency, there is also a decline in the liquidity of the foreign currency part of the reserves. According to the Bank of Russia,[3] as of early 2022, international reserves were denominated 33.9% in euros, 21.5% in gold, 17.1% in yuan, 10.9% in U.S. dollars, 6.2% in pounds and 5.2% in yen.[4] Currently, the central bank's unfrozen assets are mostly made up of yuan and gold. The new structure is less liquid, as the yuan is relatively little used in international settlements. According to SWIFT data,[5] the RMB's share of international settlements as of 2021 comes to 2.7% (versus 40.5% of the US dollar and 36.7% of the euro), and its share of central bank allocated assets[6] is 2.6%

1 Central Bank of the Islamic Republic of Iran // Annual Review. 2019. No. 20. P. 1398.
2 URL: https://cbr.ru/statistics/macro_itm/svs/ (section "Evaluation of the balance of payments of the Russian Federation (analytical presentation)").
3 URL: https://cbr.ru/Collection/Collection/File/40915/ar_2021.pdf
4 According to the Bank of Japan. URL: https://www.japantimes.co.jp/news/2022/02/28/national/japan-russia-central-bank-sanctions/
5 URL: https://www.statista.com/statistics/1189498/share-of-global-payments-by-currency/
6 URL: https://data.imf.org/?sk=E6A5F467-C14B-4AA8-9F6D-5A09EC4E62A4

(versus 58.8% of the US dollar and 20.6% of the euro). International reserves denominated in yuan can be used in a limited way, for instance, for settlements between Russia and China, as well as for repayment of foreign debt under future contracts concluded in yuan. The structure of the unfrozen part of international reserves imposes serious restrictions on transactions on the foreign exchange market due to the lower demand for RMB compared to the US dollar and Euro.

Finally, the freezing of international reserves made it impossible to implement the budget rule mechanism in its previous form. Previously, the Bank of Russia, on the instructions of the Finance Ministry of Russia, was buying (selling) foreign currency on the domestic foreign exchange market depending on the ratio of the actual and base oil prices, which significantly reduced the correlation between fluctuations in oil prices and the nominal ruble exchange rate, ensuring the functioning of the economy in conditions of oil prices close to the cut-off price (about $44/barrel). In the absence of the possibility for the Central Bank of Russia to carry out operations on the foreign exchange market (at least in the part of operations with the main reserve currencies) this correlation increases, which in the medium and long term will increase the exposure of the Russian economy to external shocks. At the same time, in the short run the current budget rule means that the Russian economy has some opportunities to adapt to the new conditions of export restrictions.

2. WHAT SHOULD BE THE STRATEGY FOR STOCK MARKET DEVELOPMENT IN THE NEW ENVIRONMENT

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The new environment calls for a rethinking of economic policy, including measures to support functioning and development of the stock market. Given the specifics of the current crisis, it is unlikely to simply replicate anti-crisis management measures used in the past. Long-term responses need to take into account factors such as the prolonged nature of sanctions, high inflation and increased ruble volatility.

In the short term, it is important to establish a rapid response to problems such as the blocking of individual assets in foreign depositories, sanctions imposed on major financial institutions and bankruptcy risks of a number of financial structures and issuers.

Current market challenges include, first-of-all, low awareness and violations of brokers' clients' rights when changing securities' custody locations, opening and closing of individual investment accounts; breaches by brokers of their obligations under their contracts with clients.

Given that the domestic market will be predominantly driven by domestic private investors, measures should be implemented encouraging their saving, offering reliable and transparent investment products, and reducing the economic and administrative burden on stock market participants. These measures are proposed in this paper.

Current state and challenges of the financial market

With the domestic stock market isolated from the global one, the scale of the falling prices of the equity securities of Russian issuers varied significantly. In the domestic market, the decline in share prices was moderate following the restoration of exchange trading from 24 March due to the ban on sales of securities by non-residents and strengthening of the ruble through introduction of currency restrictions. The capitalization of issuers at the Moscow Exchange fell from Rb 62.6 trillion in 2021 to Rb 47.2 trillion in Q 1 2022, or by 24.6%. On March 31, 2022, the Moscow Exchange index dropped by 27.7% and the RTS index fell by 36% compared to 2021.

The broad RGBI TR OFZ index fell in the bond market by 11.8% in Q1 2022, while yield to maturity rose from 8.45% at the end of 2021 to 11.83% on 1 April; the IFX-Cbonds corporate bond index fell by 2.8%, while yield to maturity rose from 8.85% to 15.15% as on 1 April. The situation on the sovereign Eurobond market is more difficult. Sovereign debt in Eurobonds amounted to $40.7 bn; Eurobonds of Russian companies amounted to $98.6 bn.

The most pressing current issues in the market are: repayment of Eurobond debts; unfreezing foreign assets owned by Russian individuals; establishing more stable laws of the game in the context of mass movements of clients' accounts and assets between brokers; protecting individual investment account

(IIA) holders from tax sanctions if they are forced to close these accounts due to sanctions; improving population awareness on particular decisions made by financial regulators and market actors.

In a number of cases, financial regulators manage to find effective solutions, for example, to maintain exchange rate stability and ruble convertibility, using ruble-denominated Eurobond redemption schemes and restoring the operation of stock and bond markets. A significant number of domestic investors responded to the Ministry of Finance's offer to repurchase the Russia-2022 bonds, thus, 72% of the entire issue was repurchased.

Long term strategy

In the long term, major risks for market actors are associated with the following problems: increased inflation and ruble volatility; insufficient domestic market liquidity; increased information asymmetry in the market due to suspending access to popular foreign information resources; bankruptcy of financial institutions and corporate bond issuers due to inability to refinance debts. The proposed measures to support private investors are structured according to the above challenges.

Mitigation of inflation risks and ruble volatility

Creating effective instruments for individuals to invest in gold and residential real estate through large exchange-traded mutual funds with physical stocks of precious metals as assets, transparent rental-type mutual funds and real estate.

A more active issue of inflation-indexed government securities available to private sector is necessary. The inflation-indexed bonds and household-focused issues still occupy a modest place in the current structure of securities issued by the Ministry of Finance. In 2021, OFZ-IN (Federal Loan Bond – Indexed Nominal) accounted for just 5.1% of the total value of OFZs in circulation and OFZ-N for just 0.3%. In our view, the Ministry of Finance should expand its OFZ-n bond sales network through the Financial Services Marketplace and brokerage and management company platforms, and maintain the yield of these OFZ issues for private investors at a level not lower than other government bond issues having a similar duration.

Eurobonds of Russian issuers have long been part of the domestic bond market. As a rule, 50–70% belong to residents. It is advisable to abandon the practice of borrowing from domestic investors using this instrument. Domestic currency bond issues should be developed in line with Russian legislation. To stimulate growth of public offerings on domestic stock exchanges, it makes sense to develop regulations to allow companies IPO under SPACs procedures, e.g. placements of shares in "blank" companies with their subsequent merger with non-public companies-targets.

It is expedient to develop the cryptocurrency market as an alternative investment asset to the dollar, and to launch cryptocurrency exchange-traded mutual funds.

Liquidity of domestic stock market

According to our estimates[1], private investors' contributions in the domestic stock, bond, mutual fund investment units and money market instruments with brokers alone amount to about $140 bn. This amount is similar to non-residents'

1 URL: http://www.cbr.ru/statistics/macro_itm/households/

investments in shares and bonds of Russian issuers. A further $170 bn to $180 bn is held as cash rubles and foreign currency by individuals. Before the events of February 2022, the share of individuals in stock market trading volumes was about 40%; after the stock market was restored on March 25, it rose to 58%. Large and liquid equity markets such as China (in Shanghai) and South Korea derive 80 and 84%, respectively, of their liquidity from private investors.[1]

On occasion, special quantitative easing programs similar to those regularly used in the US, the European Union and Japan could be used to support the domestic bond market. In order to assist corporate issuers in repaying external debt, the Bank of Russia could return to the practice of providing currency swaps, i.e. short-term financing of external debt repayment transactions.

Legal protection of private investors

The problems of high operational and credit risks for brokers' clients were evident in the case of the write-downs of Univer Capital's clients' securities. In order to address this problem, brokerage standards need to be amended to require customer consent when borrowing their securities. It would be advisable to provide in the trading rules of the Moscow Exchange for the possibility to open a separate securities trading account for those broker clients who have not authorized their broker to use their assets for lending to third parties. However, tariffs of the stock exchange and its infrastructure organizations, as well as tariffs of brokers and their depositories, should not be discriminant against the mentioned accounts and broker clients who do not authorize to borrow their assets.

There should be a client money insurance institution for brokers set up within a year with an insurance fund similar to client money security programs, (Securities Investor Protection Corporation (SIPC) for up to $500,000. SIPC does not insure against market risks, but instead recovers client funds and securities owned by bankrupt or otherwise financially distressed brokerage firms.

The functions of self-regulatory organizations (SROs) need to be clarified and their role in protecting the rights of users of financial services strengthened. In its present form, a self-regulating organization acts as a shop lobbyist and at the same time as an advocate for consumers of services provided by shop members. It is recommended to make better use of the existing international experience in this area, in particular, the FINRA association in the USA. Its main objective is consumer protection, and its revenues are generated simply as a small commission charged on each financial transaction.

Combatting risks of information asymmetry

Currently, none of the Russian information resources provide accessible information on financial performance of Russian Public Joint Stock Companies (PJSC), estimated based on consolidated financial reporting and in accordance with recognized international methodology. Given the limited access to this information by Russian market actors through Bloomberg and Reuters terminals, it creates serious difficulties in making investment decisions, as well as in objective eva–luation of financial instruments used in the accounts of financial institutions. To address this problem, a review of issuer disclosure standards and access to information by Russian information resources and their users is needed.

1 *Osipovich A. I*ndividual-Investor Boom Reshapes U.S. Stock Market // The Wall Street Journal on-line. 31 August. 2020. URL: https://www.wsj.com/articles/individual-investor-boom-reshapes-u-s-stock-market-11598866200

2. What should be the strategy for stock market

Preventing excessive concentration of business in large government agencies
Measures are needed to accelerate the development of independent fintech based on private companies (robo-advisory services, brokers, etc.) and to expand the ability of such companies to handle clients' funds and payments. Such fintech companies survive sanctions more effectively than large state-owned entities and will find opportunities for their clients to access global markets and services.

It is important to review current standards for financial intermediaries when selling high-risk products such as structured products, investment life insurance (IL) and a number of others. Facilitating policy and high transparency of investment and financial products available to the public is needed.

3. MICROFINANCE MARKET: 2021 OUTCOME AND DEVELOPMENT PROSPECTS

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In 2021, the stabilization of the macroeconomic situation fueled growth of both the microfinance market and the performance of microfinance institutions. In the meantime, the high level of borrowing and the aggravation of geopolitical risks in 2022 force the Bank of Russia to draft further restrictions on the limit of the credit total cost and the amount of indebtedness. New restrictions will encourage microfinance institutions to put in place a more careful choice of clients and develop long-term financing tools.

A total of 1,288 microfinance organizations (MFOs) operate in Russia, including 37 microfinance providers (MFPs) and 1,251 microcredit organizations (MCOs).[1] The level of concentration in the microfinance market in 2021 demonstrated an uptick, returning to the indexes of early 2020 and remaining at a relatively low level compared to the banking sector: the top 50 amass 73%, the top 100 amass 85% of the total MFO portfolio.

In 2021, the growth of key performance indicators of microfinance organizations continued, the total loans originated in the past year amounted to Rb624 bn, the total portfolio at the end of 2021 reached the value of Rb328 bn, an increase amounted to 31.6% for the year. The last year financial performance improved markedly, the net profit of MFOs in 2021 surged by 85% compared to 2020 and, according to our estimates, and amounted to around Rb30 bn. Around 90% of the cumulative growth is accounted for by 32 largest microfinance organizations, most of which showed 100% growth.

The increase in the total portfolio is primarily due to the rapid development of the online loans to retail segment, as well as a shift in focus of many large lenders towards longer-term products.

Owing to the active digitalization that began during the pandemic, the portfolio and volume of issued online microloans soared by around 100% last year. Overall, over 70% of all micro-loan agreements were concluded remotely during the year.

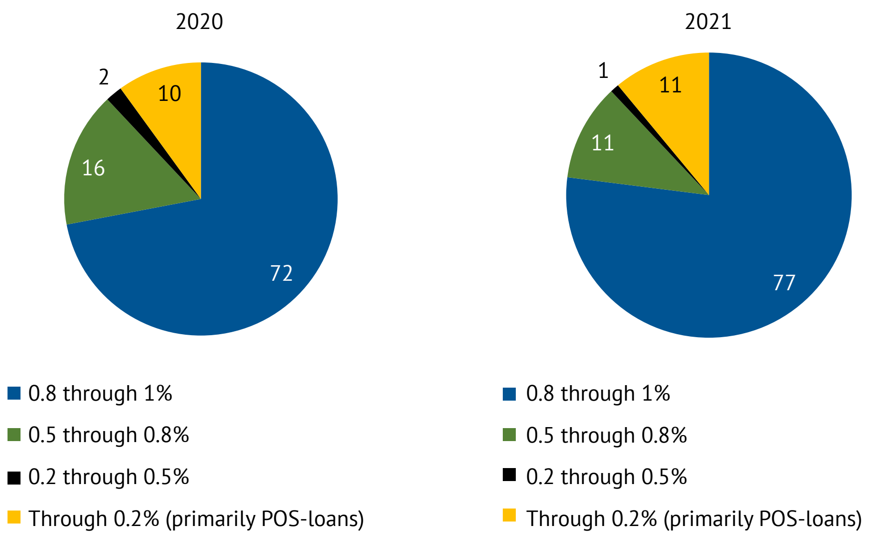
The share of long-term Installment loans (including POS-loans[2]) in the structure of disbursements hit the maximum for the entire history of the market. The introduction of digital technology has increased the share of online loans in the long-term segment.

The share of loans issued to SMEs in the total volume declined – from 24% to 19%. In general, the demand for loans from small and medium-sized businesses remains at a high level.

Loan rates for MFOs did not change much during the year, as shown in *Fig. 1*.

1 According to RF CB data as of 05.04.2022.
2 POS (point of sale) – a type of consumer credit issued directly at retail outlets.

3. Microfinance market: 2021 outcome and development prospects



* Here are the daily interest rates

Fig. 1. Share of contracts concluded in a certain interest rate range in 2020–2021*

Source: Bank of Russia website. Trends in the microfinance market in 2021. URL: https://www.cbr.ru/analytics/microfinance/mfo/mmt_2021/

The quality of portfolios compared to 2020 has not changed in general. An uptick in the share of NPLs with 90+[1] days past due in MFOs' portfolios was recorded, while the level of "short-term" past due debt (for loans issued in the current quarter) declined. On average, the NPLs with 90+ days past due regarding online companies is higher than that of offline companies.

The share of NPL 90+ days past due at the end of 2021 was 29.5% (+0.6 p.p. relative to 2020). The stable level of arrears was largely triggered by the sale of debt: the volume of cession in 2021 amounted to about 3% of the total portfolio. During 2021, 220 MFOs sold their debt (about 18% of the total number of MFOs), but the bulk of the debt (over 60%) belonged to a small number of MFPs, classified as large and medium (about 30 companies). The level of overdue debt depends on the debt load of the borrower – the share of contracts with PDL[2] over 80% in the structure of the aggregate consumer portfolio accounts for 47%.[3]

During 2021, the structure of funding of microfinance organizations underwent significant changes: the share of funds raised from individuals was 16% (a decrease of 6 p.p. over the year), funds raised from legal entities (excluding credit institutions) – 39% (a decrease of 14 p.p.). In the meantime, the share of funds raised from banks increased - it reached 45% in the total structure of raised funds (up by 20 p.p.); in absolute terms the volume of bank participation went up by 2.5-fold. The number of MFOs that attract financing from banks remained stable since the beginning of 2020 (around 40).

On average, the ratio of raised funds to the volume of issued loans during 2021 was in the range from 14 to 21%, i.e. the MFO market was more focused on working with their own funds.

1 NPL (non-performing loans) – the volume of loans in the bank's loan portfolio for which the terms of the loan agreement are not met. As a rule, loans fall into the NPL after they are overdue for more than a certain period, usually 90 days.
2 Debt load ratio (DLR)– the ratio of all payments on credit obligations of the debtor to its income.
3 On loans of up to Rb10,000 MFOs may not calculate DLR.

Due to the aggravation of the international situation and increased sanctions pressure on Russia, the microfinance market will undergo serious reforms. Back at the end of 2021, the Bank of Russia planned to tighten regulation of microfinance organizations, including putting in place criminal liability for illegal lending. Since the beginning of the year, the number of citizens' complaints against MFOs has surged by 74%.

The planned changes in the legislation regulating consumer lending will contribute to further transition of companies from the PDL to the Installment segment, the tightening of MFO scoring models and the departure of inefficient participants from the market. In particular, the draft law submitted to the State Duma proposes to put in place the following restrictions:

- reducing the limit on the full cost of credit from 1 to 0.8% per day (from 365% to 292% per annum);
- reducing the maximum amount of payments that MFOs can demand from a debtor from 1.5 to 1.3 of the loan amount (in addition to the original loan amount).[1]

The draft amendments to limit the marginal rates of consumer loans was criticized in the Duma – there were proposals to reduce the rates to 0.5%. According to market participants, it may be unacceptable for MFO[2]: profitability will go into negative territory, for many of its participants operation in this market will become unprofitable, a large number of players will abandon it, the remaining will try to change the business model.

In the long term, the microfinance market is set to undergo major changes due to digital transformation. New regulatory norms of the Bank of Russia related to the reduction of maximum rates and tightening of loan scoring will force businesses to look for opportunities to reduce costs, otherwise it will be difficult to avoid negative profitability. A way out of this situation may be the emergence of new, primarily large fintech companies capable of offering technological solutions to the problems, such as loan scoring using machine learning and predictive analytics instead of increasing the interest rate on the riskiest customer categories. The implementation of Bank of Russia projects in the digital sphere (biometric identification, marketplace) will also contribute to the gradual transformation of the microfinance market.

1 URL; https://www.cbr.ru/Collection/Collection/File/39665/review_mfi_21Q3.pdf
2 URL; https://www.rbc.ru/newspaper/2022/02/17/620cc9979a7947ee36fc8013

4. SANCTIONS HAVE NOT YET GENERATED GROWTH IN UNEMPLOYMENT

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Economic sanctions and the suspension of the business activities have not yet led to a significant increase in unemployment, as most companies retain their employees and continue to pay them all or part of their wages. There are risks of a gradual rise in unemployment amid the decline in hiring.

There is practically no real-time official statistical data to assess the situation in the labor market. The results of the March labor force survey will be unavailable until mid to late April. Real-time data available to the Ministry of Labor and Social Protection comes only from large and medium-sized enterprises where less than half of all employed in Russia work.

Publicly available information suggests that the current impact of sanctions on the labor market is as follows.

Firstly, faced with the disruption of the already familiar production chains, business began to reduce output and, in some cases, to stop production altogether. For example, in the absence of a sufficient supply of components (primarily electronic chips, which are in short supply worldwide), AvtoVAZ is sending its employees to downtime with a corresponding reduction in wages. Whereas in the near future it is not possible to restore the old chains or set up new ones in the near future, other large and medium-sized businesses will resort to similar solutions.

Secondly, many foreign companies have suspended their activities in Russia. Although there are no exact data, individual cases (IKEA, McDonald's, various car assembly plants – Renault, Ford Sollers, Hyundai, Nissan, Toyota, Avtotor Holding) show that companies retain employees and continue to pay them full or partial wages in accordance with Russian legislation on idle pay – 2/3 of the average wage. Having said that, the segment of such companies in the Russian labor market is relatively low – no more than 1 million employees even when taking into account related Russian enterprises, such as farms producing products to be sold directly to McDonald's.

In view of this, the sanctions have not yet led to a hike in unemployment, as it was in March-April 2020, when its level rose by 1.4 p.p. in two months. Rather, one should expect a slow rise in unemployment, as enterprises will first put workers on administrative leave, and only then, if the current situation persists, will they resort to layoffs.

In late February and early March, the number of voluntary resignations might even decrease, as employees will try to hold on to their current jobs as long as possible amid uncertainty. This is exactly the picture observed in the Russian

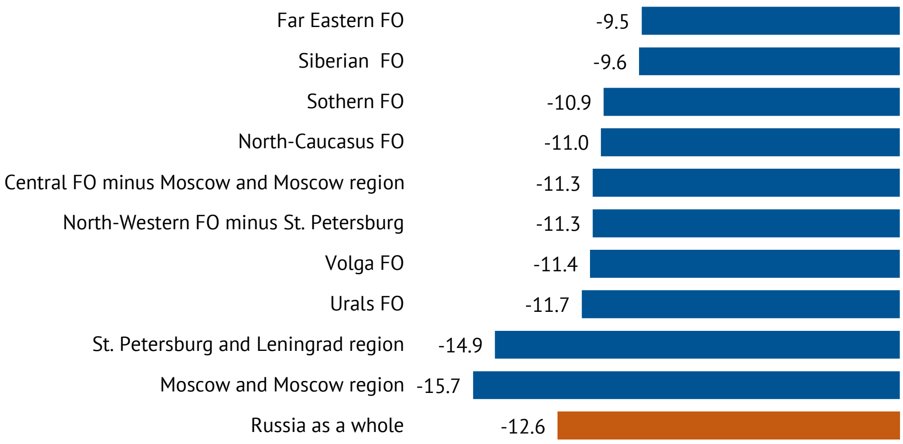

Fig. 1. The dynamics of the number of current vacancies on hh.ru between February 14–20 and March 7–13, %

Source: hh.ru data

labor market in 2020. Nevertheless, as hiring in Russia has declined sharply since late February, the unemployment rate will gradually go up.

A drop in the number of hires in the absence of a significant influx of job seekers has been noted by Russia’s largest private employment agency, HeadHunter. According to the company, in the three weeks between February 14–20 and March 7–13, the number of active CVs declined by 12.6%. Meanwhile, the number of CVs created or updated in the past 60 days increased by 8.3%, consistent with the seasonal dynamics of the past few years. As a result, the hh. index, which demonstrates the ratio of the number of active CVs to the number of current job openings, rose from 3.9 in mid-February to 4.8 in the second week of March.

The largest decrease in the number of vacancies was observed in the metropolitan regions (*Fig. 1*). First of all, there were fewer vacancies in such professional spheres as insurance (-48%), automobile business (-27%), personnel management (-22%); to a lesser extent - in security (-3%), medicine and pharmaceutics (-6%). The number of vacancies in the civil service and non-profit organizations grew by 21% during the same period.

The phone survey conducted by INSAP RANEPA in the second week of March,[1] also demonstrated no increase in the rate of the unemployed compared to the January survey. Only about 3% of swage earners noted that at the time of the survey they had been placed on paid, partially paid or involuntary unpaid leave at their main job, and another 2% had been placed on reduced working hours. Only 3% of workers reported wage delays for February. In general, such values are common for the Russian labor market.

Most workers are cautiously optimistic about the future; 78% of them rate the risk of losing their job next month as low or very low; 73% of respondents expect their pay to be flat or even higher in March; 80% of workers think they will work as usual in March, while 3% think they may lose their job; 7% have difficulty in answering; the remaining 9% think they will be moved to various vacation or reduced workday options.

1 The survey was conducted on March 9–10, 2022, with a sample size of 1,630 respondents. Russian citizens aged 18 years and older from all regions of Russia were surveyed. Quotas per strata were distributed according to Rosstat data.

4. Sanctions have not yet generated growth in unemployment

Consequently, the growth of unemployment in the spring months will be limited. However, if economic sanctions remain in place and Russian and foreign organizations suspend their activities, in the summer months we can expect a gradual increase in the number of layoffs and the introduction by enterprises of more stringent mechanisms to reduce labor costs: transfers not to downtime, where businesses have to pay a large share of wages, but to unpaid administrative leave; small businesses may also resort to wage delays.

At present, it is almost impossible to predict the extent of unemployment because there are too many unknown externalities. Moreover, it seems that the accuracy of all open forecasts is very low now. Nevertheless, we can expect wages to fall in real terms for most Russian workers as early as March. The economic sanctions will have a negative impact on most areas of the Russian economy one way or another, so a drop in wages will be felt by almost all employed in Russia.