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Russia Faces a Wave of Bankruptcies as Borrowing Costs Skyrocket

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Russian businesses are bracing themselves for a financial crunch that could put many of them out of business. The Central Bank's interest rate has reached a crushing 21%, with expectations for a further hike in December, and over the last two years, companies have built up significant commercial debt with floating-rate interest payments.

The Central Bank has progressively raised rates since the second quarter of 2023 in a bid to control persistent inflation and support the faltering ruble. However, the soaring cost of borrowing is now pushing many companies toward a dangerous debt spiral, with interest payments consuming one out of every four rubles they earn.

Late payments from customers and partners have been climbing, signaling distress in the corporate sector as firms struggle to service debt under such high rates. With real interest rates once bank premiums are factored in effectively reaching 25% for businesses, the likelihood of defaults and bankruptcies has risen sharply, Meduza reports.

Before the war, only around 20% of corporate loans were issued at floating rates. By mid-2023, however, that share had surged to 44%, as businesses took out loans with terms pegged to the Central Bank's key rate. Many firms, driven by the need for capital to support import substitution after the imposition of sanctions and to acquire assets as foreign companies left Russia, borrowed heavily — and under the assumption that interest rates would eventually stabilize or decrease.

That didn't happen. Heavy government spending overheated the economy and sent inflation soaring. The Central Bank began an aggressive rate-hike tightening cycle that has not ended yet.

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By late 2024, floating-rate loans constituted 53% of corporate borrowing. This surge, combined with the weakened ruble and heightened government spending, drove up inflation, fueling further rate hikes.

The demand for loans has also soared as businesses race to lock in capital ahead of anticipated new restrictions. Tightened reserve requirements and stricter lending standards are expected to come into force by year-end, leading companies to expand their loan portfolios by 22% in the past year alone.

The situation will only get worse. Building up debt was not a problem while the economy was growing, turning in a surprise 3.6% expansion in 2023, but as bne IntelliNews reported, Russia's economy is cooling and a sharp slowdown is expected in 2025 that will only increase the pressure on corporations further. The prospects for the Central Bank to switch to easing monetary policy remain remote as long as the war in Ukraine continues.

Corporate bankruptcies in Russia have jumped by 20% this year as soaring interest rates and liquidity shortages push firms closer to financial ruin, according to data from the Unified Federal Registry of Bankruptcy Declarations (Fedresurs), Meduza reports.

The uptick in insolvencies, though initially concentrated in the first quarter, is poised to accelerate as tighter monetary conditions make debt servicing increasingly unsustainable.

Signs of distress have intensified in recent months, with the Russian Union of Industrialists and Entrepreneurs (RSPP) reporting a substantial rise in complaints over late payments.

"Previously, 22% of business owners faced this issue, but that figure has now jumped to 37%," said the union as cited by Meduza. The RSPP attributes the escalation to the difficulty of assessing working capital loans, a situation forcing many companies to delay payments to suppliers and other creditors.

The retail sector is especially vulnerable. Russia's Union of Shopping Centers has petitioned the government for critical relief measures, including subsidized interest rates of 7-10%, debt restructuring, and payment deferrals of five to 10 years, reports Kommersant. Without such interventions, the union warns, 200 shopping centers could face bankruptcy within the coming months. Similarly, office and warehouse owners are attempting to renegotiate terms with creditors.

Officials are increasingly sounding the alarm bell. Sergei Chemezov, CEO of the state-owned defense conglomerate Rostec, warned that the current lending environment is untenable for manufacturers whose production cycles exceed a year.

"If we keep operating like this, most of our businesses will go bankrupt," Chemezov said in October, adding that even high-revenue arms sales are insufficient to offset debt costs at rates exceeding 20%.

"If a product's manufacturing cycle takes a year, advance payments cover only 40% of production costs. The rest must be borrowed, but high interest rates wipe out all profits," he added.

Red lights are also flashing in the corporate bond market, where high rates are making bonds unaffordable as a source of capital. A key risk measure, the net debt-to-EBITDA ratio, has surged among lower-tier firms, with Gazprombank estimating this metric now exceeds three. While previously manageable, this debt-to-earnings ratio has become perilous under today's interest rates, which is already forcing some companies to spend three out of four rules they earn to service debt.

The high rates have also made rolling maturing bonds over untenable, putting even more pressure on corporate reserves as management had not planned to retire their debt at this stage and assumed that bonds could be refinanced. To refinance maturing bonds, companies are now forced to offer yields around 27% to attract investors wary of default risks, according to credit rating agency Expert RA, as cited by Meduza.

Industries on the frontlines include paper and wood processing, wholesale trade and agriculture. Russia's coal industry is already in crisis after EU markets were closed by sanctions. The construction sector, particularly vulnerable to delayed payments, has been hit by a double whammy after a generous mortgage subsidy program was ended on July 1, sending the cost of borrowing for would-be homeowners upwards. Mortgage loan applications halved in July alone as Russia's real estate market was rocked by the decision.

Real estate companies have responded by offering their own financing programs, similar to the subprime model used in the U.S. that caused the 2008 global financial crisis. Borrowers can take out cheap loans with rates well below the regulator's prime rate for a fixed period of a few years, but the rates will rise to match the prime rate after the honeymoon period is over. It's a bet that the Central Bank will reverse its monetary policy in a few years — in other words it's a bet that the war in Ukraine will stop soon — and rates will fall again. But if that doesn't happen, Russia will face a major housing-induced financial crisis.

Retail loans have also been hit by a double whammy as the Central Bank attempted to cool mushrooming consumer borrowing that was adding to inflation as part of its non-monetary policy methods to cool the economy and bring inflation down. The United Credit Bureau has reported a notable decline in average credit scores across Russia. By October 2024, the likelihood of default among consumers had risen by 12% compared to the previous year, and long-term overdue payments are becoming more prevalent. That is worrying the regulator, which reports a build-up in the concentrations of debt that could precipitate a financial crisis.

Historically, corporate bankruptcies and bond defaults tend to surge three to six months after rate hikes, reports Meduza, a trend that could manifest before year-end as companies face imminent bond repayments. Many corporate bonds mature in the fourth quarter of this year, and with investor sentiment fragile, refinancing options remain costly and elusive.

Oligarch Alexei Mordashov, the founder of steel mill Severstal, put it this way: “At the current interest rate, it’s more profitable for companies to halt expansion or even downsize and put funds in the bank rather than continue operations and take on the associated risks,” Meduza reports.

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